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HONEY, THEY SHRUNK THE FED

Why Greenspan successor BEN BERNANKE will preside over a diminished central bank

BY RICH MILLER (P. 30)

The Federal Reserve
(Photo illustration)

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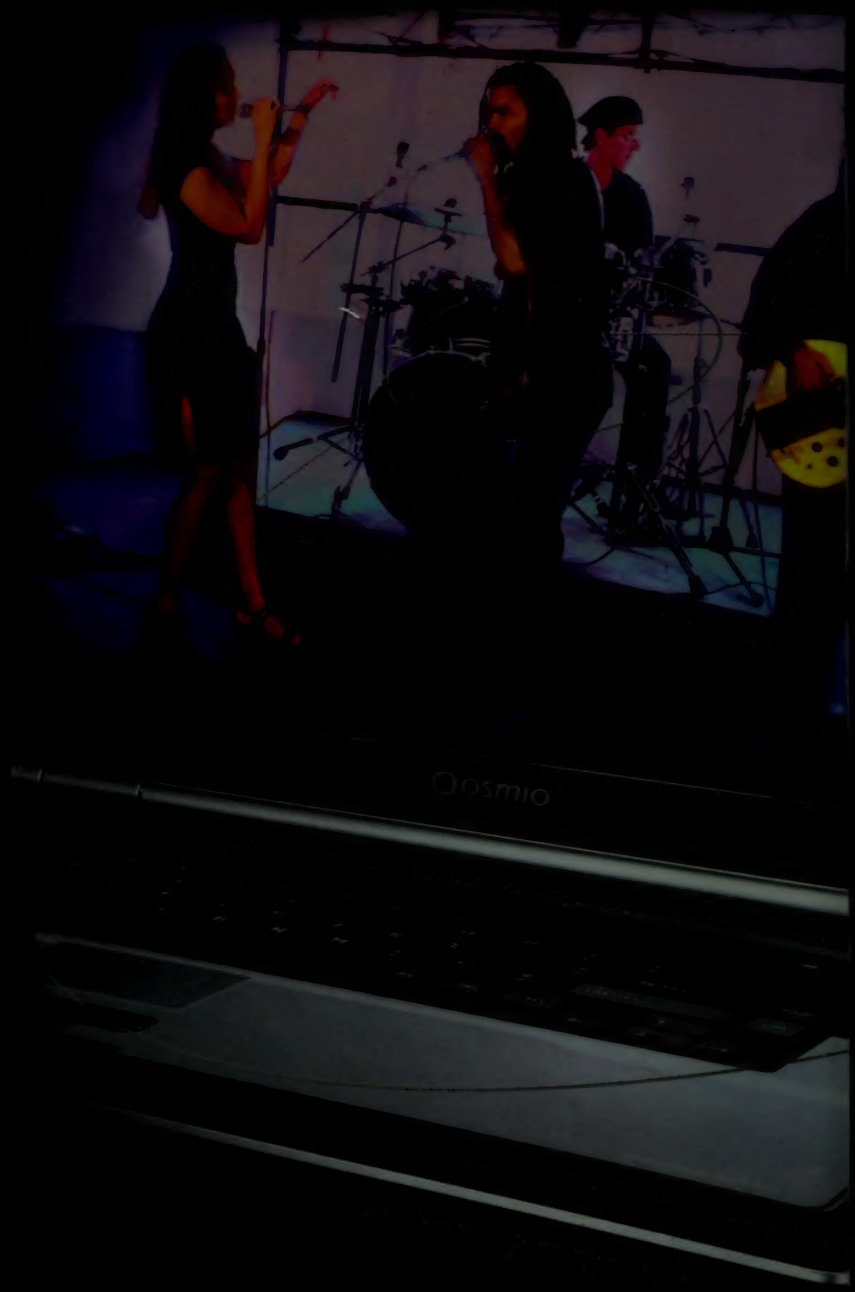

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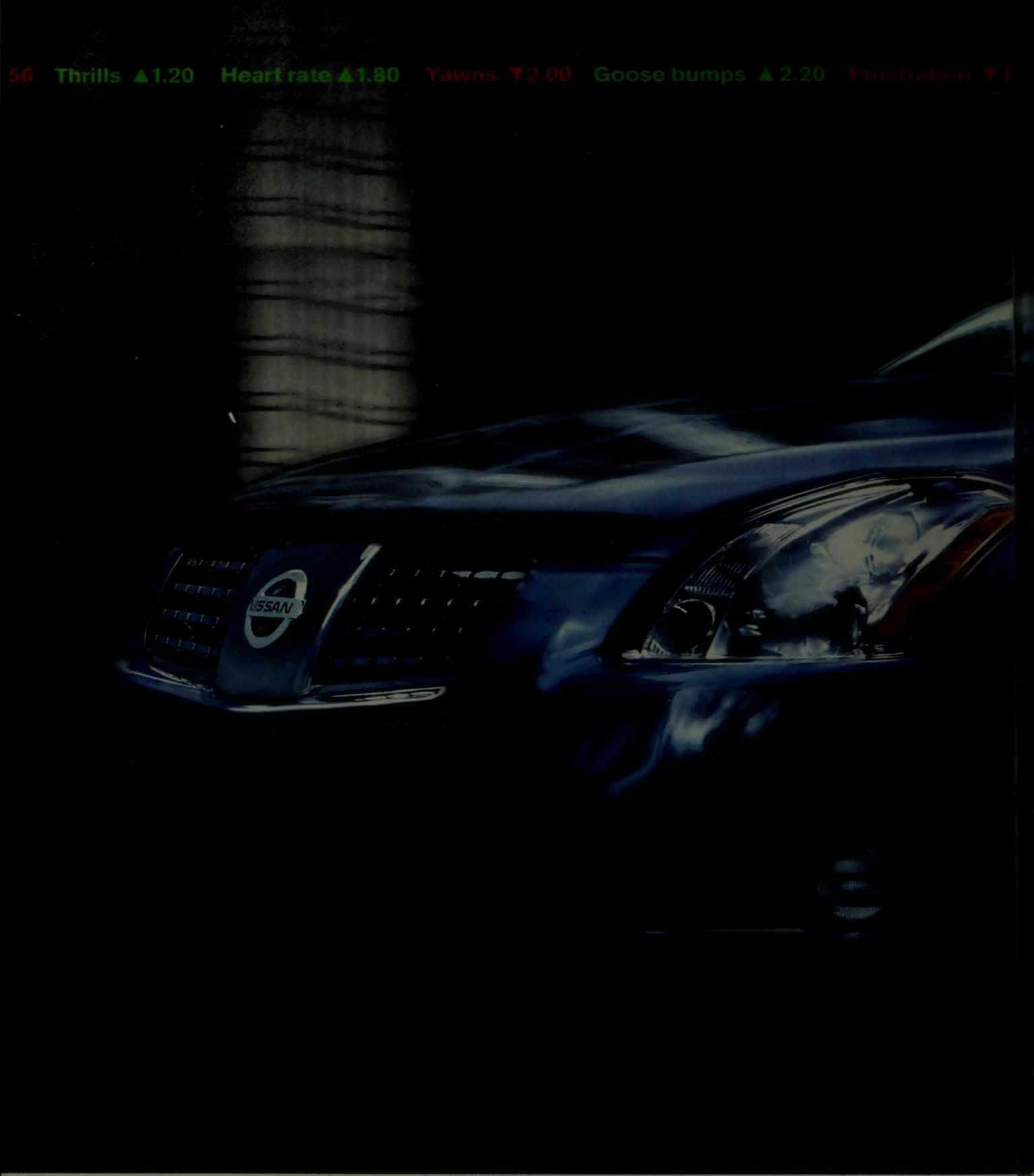

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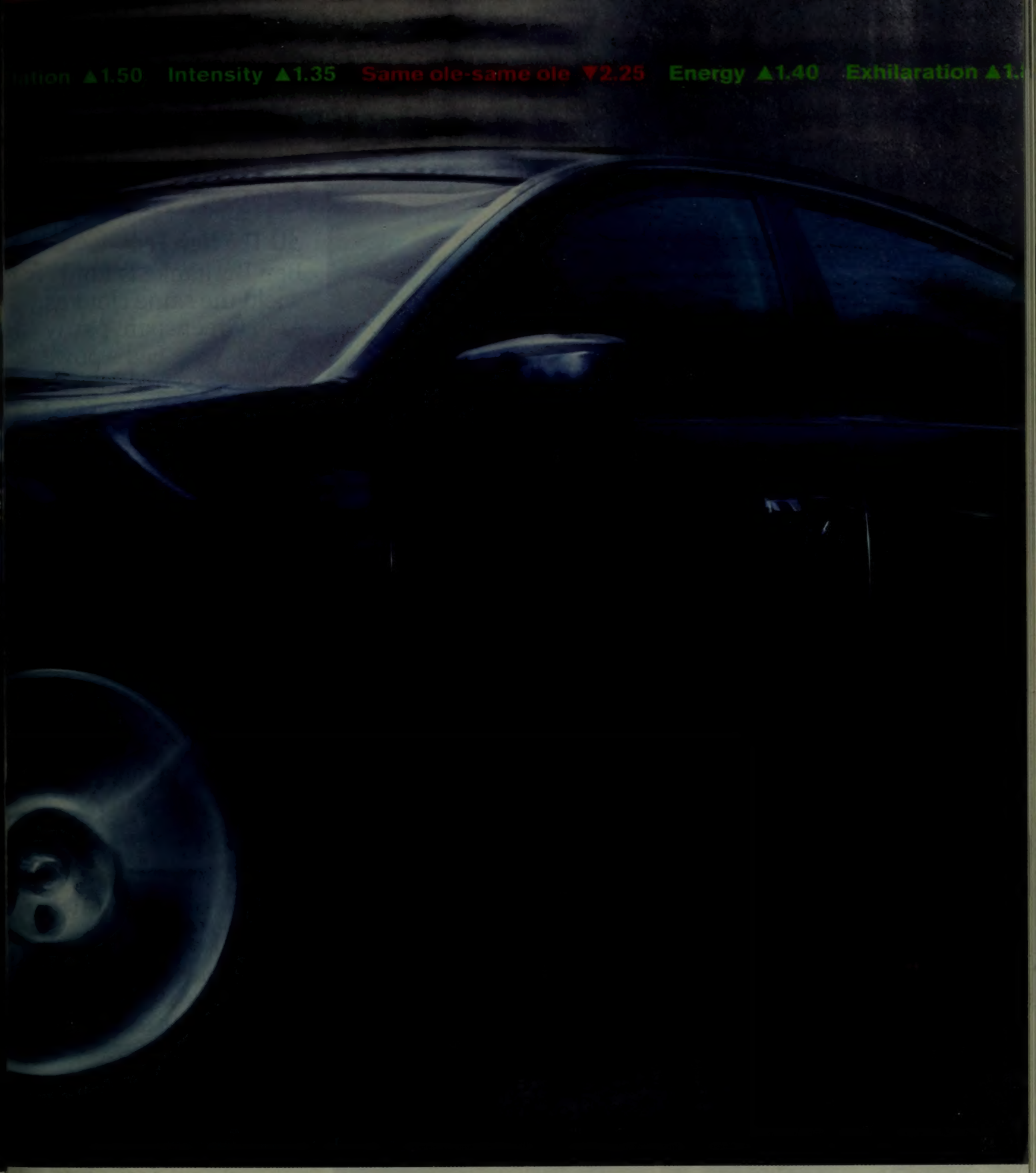

The 265-hp Nissan Maxima

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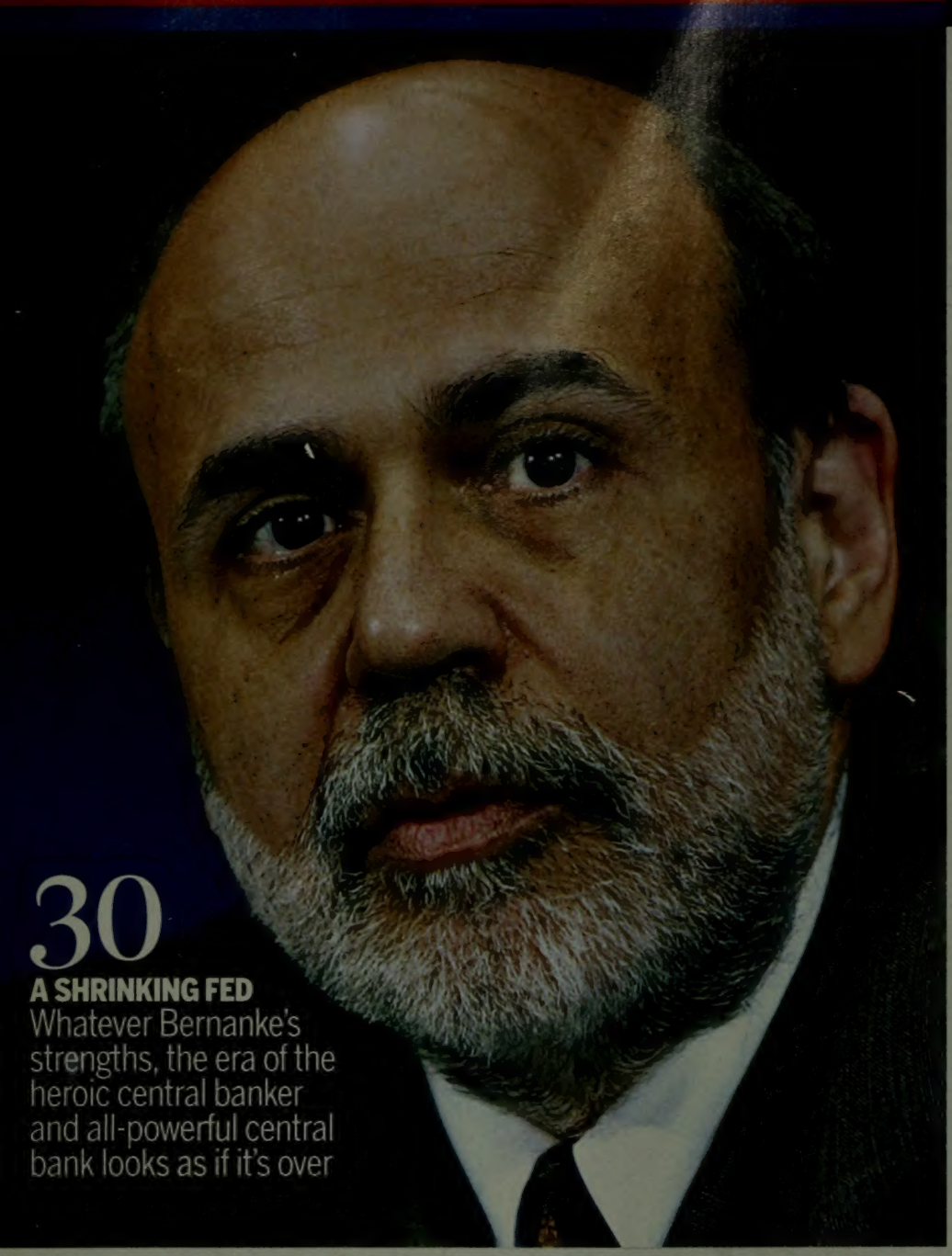
BusinessWeek

November 7, 2005



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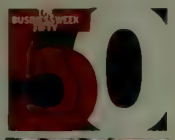

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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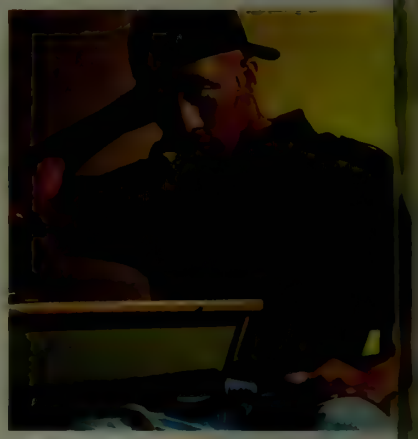
Special Report: Tech's New Youth Movement



As Net companies and the economy in general have rebounded, so has the **college-age entrepreneur.** And while the bar is higher today than during the dot-com bubble, investors are again starting to take notice of the good ones. This special report highlights some of the more promising up-and-comers, such as 25-year-old **Ejovi Nuwere** and his Net-telephony security startup. You'll find him and plenty of others in our slide show of **tech's fresh faces.** Also, tips from a veteran Valley venture capitalist, and more

Beating the Market by Expecting the Unexpected

Fooled by Randomness has been a Wall Street cult favorite since 2001. With a new edition, author Nassim Nicholas Taleb continues his fight to help readers understand the limits of predictive powers

An Innovation Influx from Independent Gamers

Greg Costikyan hopes his site, Manifesto, will be "the Miramax of independent games," revitalizing an industry clogged with sequels and movie tie-ins. Plus: A slide-show peek at his favorite indie offerings

Teaching Entrepreneurs—And Dodging Shrapnel

When consultant Ted Hilliard joined the Army Reserves in 1997, little did he expect he'd be helping to develop small businesses in Iraq

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UP Front

"It is time to invest in America."

–House Speaker Dennis Hastert, calling on oil companies to ease the pain of high energy prices by investing more of their record profits

EDITED BY DAN BEUCKE

TEEN SCENE

MYSPACE KEEPS GETTING BIGGER

ANY 16-YEAR-OLD can tell you that logging on to **MySpace.com** is as vital to teen culture as showing your face at the right party. Now, with 34 million users, the social networking site is

becoming a can't-miss for advertisers as well. During September, 1 out of 10 ads viewed on the Internet was seen on MySpace, according to **Nielsen//NetRatings**. Only **Yahoo!** and **MSN** boast higher ad views. That reflects MySpace's rising visibility: Users have nearly quadrupled since January. Advertisers also are intrigued by the relatively low cost of a campaign—$80,000 to $300,000 for four to six weeks—to reach the fickle teen audience. **Procter & Gamble,** for instance, recently sponsored profiles for Hilary Duff and other pop stars. "It's an experiment for us," says a spokesperson for **P&G's** Secret Sparkle Body Spray.

With backing from new owner **News Corp.**, MySpace co-founders Tom Anderson and Chris DeWolfe (left) are experimenting, too. They plan to launch a MySpace record label, film production company, and satellite-radio station. They are even considering a mobile service to go up against teen-targeted cell-phone plans from **Sprint Nextel's Boost Mobile** and **Virgin Mobile**. *–Jessi Hempel*

WIRED LIFE

Mini-Microsoft's Blogjam

YOU CAN BE TOO popular on the Web. Just ask **Mini-Microsoft**, the anonymous blogger who works inside the software giant and opines about corporate bloat. Mini had a small but thoughtful audience before *BusinessWeek* profiled him ("A Rendezvous with Microsoft's Deep Throat," Sept. 26). Then he made C/Net's Blog 100 list. Traffic to the blog exploded. Mini's posts, which had gotten as many as 50 responses apiece, got hit with 250 or more. Quantity outran quality. **Microsoft** software developers and testers sniped at one another. Blog squatters from the outside set up shop and derailed discussions to such random topics as the effects of the Redmond, Wash., weather on Microsoft's workforce. Mini's message was getting lost.

So on Oct. 15, Mini flipped the digital switch, preventing readers from commenting on his posts. "I grieve the loss of comments, as I'm sure a lot of you do out there," Mini wrote. "It was just becoming harder to find the gems in the middle of egregious brain-misfires." But the result wasn't the riveting water cooler readers had come to expect. So on Oct. 24, Mini backtracked, writing that he'd turn comments back on. Now he'll spend more time filtering out the blather. *–Jay Greene*

THE BIG PICTURE

NAME GAME Every corporate strategy needs a slogan. Some are straightforward; others are more mysterious. See if you can match the slogans and project names with the company.

1 *Adapting To Scale*	**Google**
2 *Plan To Win*	**Bank of America**
3 *Fit4More*	**GE**
4 *Imagination Breakthroughs*	**Pfizer**
5 *Higher Standards*	**Siemens**
6 *Don't Be Evil*	**McDonald's**

ANSWER: 1) PFIZER, 2) McDONALD'S, 3) SIEMENS, 4) GE, 5) BANK OF AMERICA 6) GOOGLE

Data: *BusinessWeek*

UP Front

JAPAN WATCH

LAND OF THE DIMMING SUNSET YEARS

SPARE A THOUGHT for Japan's future retirees. Until recently, your average salaryman had every right to expect a comfortable old age cushioned by a hefty golden goodbye payout at 60, plus ample monthly pension checks. Today, those benefits are under attack.

At the state level, the **Koizumi government** is pressing ahead with social security reforms. When passed into law, they will almost certainly trim state pension payouts while raising taxes to offset a growing pensions shortfall as Japan's population grays. What's more, companies are getting in on the act. Following the example set by U.S. counterparts, Japanese employers are dumping defined benefit pension schemes in favor of cheaper alternatives. According to **Greenwich Associates** of Greenwich, Conn., a quarter of Japan's defined benefit plans will be closed to new employees by 2008, compared with just 6% two years ago. By 2015, only half of Japanese corporate pensions will be of the defined benefit type, Greenwich expects. "A generational shift has begun regarding corporate responsibilities for workers' retirement," says William Weschler, a consultant at Greenwich.

U.S. 401(k)-style plans will fill some of the gap. They had over 1.25 million subscribers in Japan through March, a 78% rise from a year earlier. Reforms are needed: Assets of the typical Japanese pension fund cover only 83% of liabilities. With the proportion of Japan's 65-plus population set to rise from 19.5% today to 27.8% by 2020, tougher times for the silver set are just beginning. *–Ian Rowley*

WOOLANTHROPISTS

CEOs SEE their faces emblazoned everywhere from the company Web page to the annual report. But only a select few are immortalized in latch-hook rugs. Using Photoshop and hand-knotted yarn, Brooklyn artist Rob Conger has created 2.5-by-2-foot latch-hook portraits of some of the most charitable CEOs. Included are John Rowe of Aetna (left), James Dimon, now president of JPMorgan Chase (right), and Phil Condit of Boeing. "The minute I put down my hook" Condit resigned, says Conger. "I was like, whoops." Earlier works, such as Alan Greenspan, sold quickly to CEOs and other collectors. The latest rugs are available at Conger's gallery, Mixed Greens, for $4,000 each. *–Elizabeth Woyke*

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UP Front

FACE TIME

HENRY SILVERMAN

Cendant Chairman and CEO Henry Silverman is back in dealmaking mode. But this time, he's breaking things up—announcing on Oct. 24 that the real estate and travel conglomerate will split into four publicly traded operations next summer. "Having built this business over 15 years, disaggregating it is emotionally wrenching," says Silverman, 65. He had argued that Cendant hedged against travel and real estate cycles, but investors didn't reward that complex model. Now they seem more focused on Cendant's weakening business prospects. The same day Cendant announced the overhaul, it lowered earnings guidance for the fourth quarter and all of 2006; its travel units have been hit by factors like terrorism and hurricanes. That day, the stock sank 7%, to 18.77.

Silverman argues that his breakup plan will still create billions of dollars in value. He will lead the new travel company, including online businesses. He figures he will step down in a couple years when protégé Samuel Katz is ready to take the helm. What then? "I hope I'm healthy, and I'll worry about it [later]," says Silverman. *–Amy Barrett*

RACE REPORT

WHEN YOU CAN'T BE WHO YOU ARE

A NEW STUDY of minorities in corporations finds that African Americans, Asians, and others are held back by subtle discrimination. Princeton University professor of religion Cornel West and economist Sylvia Ann Hewlett discussed their findings with Senior Writer Nanette Byrnes:

Q. The people you spoke with seem to feel they have to act like white men to get ahead.

Hewlett: There's this great phrase "bleached-out professionalism." That describes this shrinkage of authenticity, which in the end is very debilitating and by definition not successful. You just can't turn yourself into a white guy.

Q. What does it mean to act like a white guy?

Hewlett: A lot of Asian executives we interviewed thought that they were way too quiet. African American executives, on the other hand, often felt they came over as too loud, too brash. They felt this loudness labeled them as potential troublemakers.

Q. Isn't the superficial sometimes important—the trust inspired by a banker's suit, etc.?

Hewlett: But a lot of the things they're talking about you basically can't change. They feel they're not allowed to bring their whole self to work. A woman who was in one of our focus groups was 32. She had been promoted three times since business school—a highflier. In her spare time she founded a Girl Scout troop in a homeless shelter. Do you think her colleagues knew about it, or her boss? No. It was kind of her choice, but she said the culture of this company is that if you are on the board of the symphony, it's O.K. United Way is O.K. But the community involvement of minority professionals is often not on the list.

Q. Is it possible white men are getting ahead faster because they're working harder?

West: There's no getting around sacrifice, excellence, and quality. We're talking about style: how one talks, relates, and balances their life. We're talking about a deepening and refining of values.

Q: What shocked you?

West: The most frightening fact is that 52% of the minority folk don't have deep trust in their company and the people who run it. We're already dealing with distrust of the government. We don't need more isolation.

BLOGSPOTTING

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» WHO'S BEHIND IT Produced by the Washington law firm of **Goldstein & Howe,** whose specialists in Supreme Court cases add their own analysis.

» NOTABLE POST: Details of legal wrangling as terror suspect **Zacarias Moussaoui** (left) seeks to avoid the death penalty. "[P]ictures of thousands of victims would be kept out [of the first stage of a jury trial], giving Moussaoui what his lawyers hope would be a better chance of convincing the jury that he is not eligible for a death sentence."

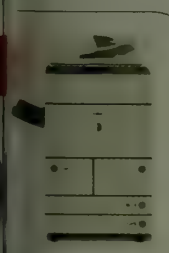
FOR THE LATEST on blogs, see Stephen Baker and Heather Green at **blogspotting.net**

THE STAT

52

The percentage of college students who believe it's O.K. to download and swap copyrighted files, even in the workplace. Percentage of faculty and administrators who agree: 25.

Data: 2005 Student and Academic Survey, the Business Software Alliance/Ipsos



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CORRECTIONS & CLARIFICATIONS

In "Finding fertile ground overseas" (Personal Business, Oct. 17), a table listi year-to-date returns for five global and international real estate funds should ha noted that for two funds—the AIM Globa Real Estate Fund and the Cohen & Steer International Realty fund—the performa e was measured from the funds' inception dates of Apr. 29 and Mar. 31, respectivel

"A hard ride for eDonkey" (Information Technology, Oct. 24) should have given Mary Kay Inc. as the cosmetics compan correct name.

"An ugly split over business taxes" (News Analysis & Commentary, Oct. 31) incorrectly said that the current mortga interest deduction offsets 35% of interes on mortgages up to $1 million. The value the deduction varies and can range from 10% to 35%.

about the housing bubble and who is go ing to get spanked when the bu ble bursts. It's most likely going to be the ny ers of the new housing on the outer e es of the current development.

The edges of the '80s and early 0 housing boom were Fairfax Station nd Centreville, Va. When the real e ate market swooned in 1988-92, those ks were stuck with property that couldn be refinanced and couldn't be sold, exce a a sizable loss. Because I live relat ly close in, my house did not drop in va e. It'll just increase at a slower rate.

–Karen G. Hob oo
Springfield Va

THE HOUSING market boom is b ng fueled by variable rate loans, man of which are based on LIBOR (London in terbank offered rate), as well as un n ventional loans, such as 100% loan o value financing. Unfortunately, wha w are now seeing is two bad trends for he housing market: a naturally upw rd trend in interest rates due to this stag of the business cycle and inflationary p s sures from an oil price shock.

–Robert M. Si e
Hamden, C n

I WAS STRUCK by the manner in w ch the homeowner in Purcellville, Va., stat d "We don't worry about $3-a-gallon g o line or the price of propane." Point of view such as his expose the reality of he exurbs: It's not about a sense of comm n ty or shared experiences—it's about ech

homeowner's prerogative to consume energy and land in order to live the American dream. Damn the commonweal!

I'd much rather live in my modest city home, five minutes from my job, and eight miles from an Atlantic Ocean beach.

–R. J. Hogan
Wilmington, N.C.

VITAMIN E SUPPLEMENTS: THE JURY IS STILL OUT

"THE STAT" (Up Front, Oct. 17), which says that 95% of Americans aren't getting enough Vitamin E, references the U.S. Agricultural Services Food Survey Research Group. While the Web site uses the nutrition figures that you quoted, it also includes the following information: "The prevalence of inadequate intakes of vitamin E, absence of signs of deficiency in the U.S. population, and increasing evidence of its beneficial effect in reducing chronic disease risk points to a need for further research."

–Sydney Parlow
Boston

GOOGLE'S G-MAIL HAS PLENTY OF POTENTIAL

THE GOOGLE-SUN Microsystems agreement initially didn't make a great deal of sense to me. ("A deal pregnant with possibility," News: Analysis & Commentary, Oct. 17). After reading your article, however, I was reminded that Google's G-mail allows users 2.5 GB of storage space.

For most people, that would be a huge amount of space for just e-mail, but when considered as a repository for online pictures and open office documents, it's a good start. This may be the beginning of a more "on-demand" partnership, as your article suggests.

–Walt Keneip
Oak Park, Ill..

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Technology&You

BY STEPHEN H. WILDSTROM

Video iPod, I Love You

Nearly everyone who has had a chance to use Apple's newest, video-enabled iPod has fallen in love at first sight, myself included. Like the original music player of 2001, the new iPod does things that others have done before, but it does them vastly better. How is it that Apple manages to stay so far out front in the hotly competitive field of digital entertainment?

I think there is actually a surprisingly simple answer: Apple Computer's products and services are designed with the single overarching concern of delivering a great consumer experience. I'm a big believer in digital video in all its forms, but my experience with download services and portable players has been mostly awful.

Until the iPod, the most sophisticated products were players from Creative Labs, Samsung, and others built to Microsoft's Portable Media Center (PMC) design. There are two ways to get video into a PMC: You can record TV shows yourself with a TiVo or Media Center PC, or you can subscribe to one of several services that offer second-tier content. For example, Comedy Central offers several programs for the PMC, but not the popular *South Park* and *The Daily Show*. There is no single place to buy content. And the process of getting the video from your PC to the portable player isn't terribly intuitive. No wonder sales of these products are minuscule.

AFTER THE MUSIC iPOD CAME OUT, buyers had to wait a year and a half before the iTunes Music Store began selling downloads. Now the video content is available from the get-go. The iTunes Store offers hundreds of music videos, movie trailers, a bit of original Pixar Animation Studios content, and—most important—five top-rated TV shows from ABC and the Disney Channel available for download the day after they air. Getting these shows requires two simple steps: You download the video to the iTunes software in your PC or Mac, then you transfer it from the computer to the iPod. And while the initial content is limited, it won't stay that way for long. Greg Joswiak, Apple's vice-president for iPod marketing, says Disney is the only player right now simply because it is the only studio Apple told in advance about the video iPod.

Lovely as the new iPod is, keep in mind that it is still a device small enough to slip easily into a pocket. That means you're watching TV on a 2½-inch display while holding the player in one hand—not the world's greatest viewing experience. But watching video is not limited to that tiny screen. You can watch iTunes video on your PC or Mac. And

POCKET WATCHING As with music iPods, user-friendliness is key

with an optional $19 cable, you can connect the iPod to a TV and watch on a big screen. The iTunes video is 320 x 240 pixels, about a quarter of the information in a DVD-quality image. When I connected the iPod to 19- and 27-in. standard TVs, the picture looked about as good as a broadcast. It was grainy and fuzzy on a 32-in. high-definition liquid-crystal display—but that's just for now. Over time, as network connections get faster and studios grow comfortable with the idea of high-quality downloads, high-resolution versions will become available.

The deal with Disney could mark a new era for digital media

Perhaps most important, Apple has again done consumers a service by playing the trailblazer, persuading a top-tier studio to provide good content despite its fears of piracy and disruption to its distribution model. Competitors, especially Microsoft, won't just back off while Apple locks up the video market, but they face a big challenge. In digital entertainment, with so many irons in the fire, Microsoft has been unable to duplicate Apple's single-minded focus on consumers. The software giant's partners, mainly engineering-driven Asian manufacturers, design great hardware. But so far they have not been able to match Apple's user-friendliness. Looks like Apple could be in for a good video ride. ■

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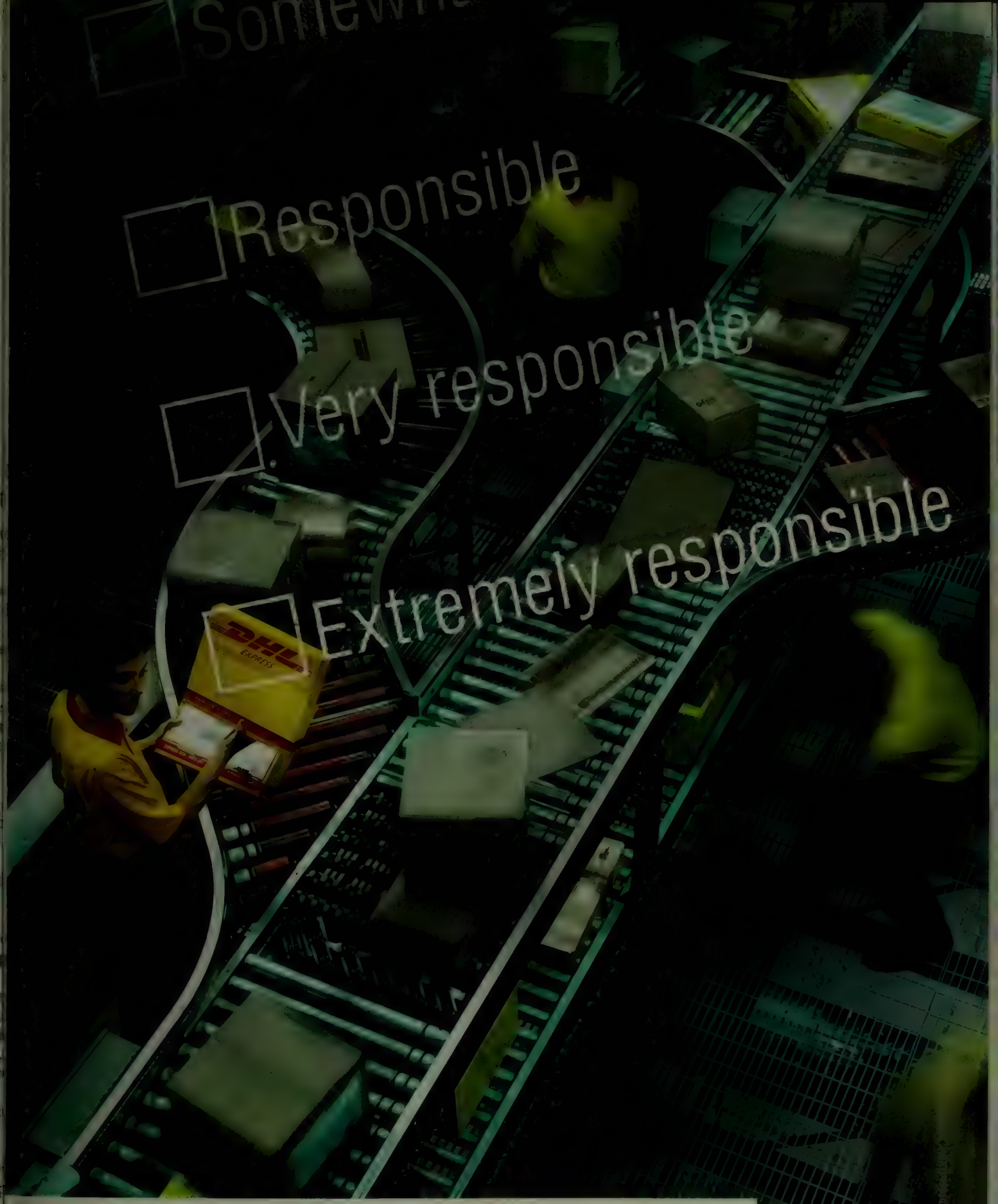

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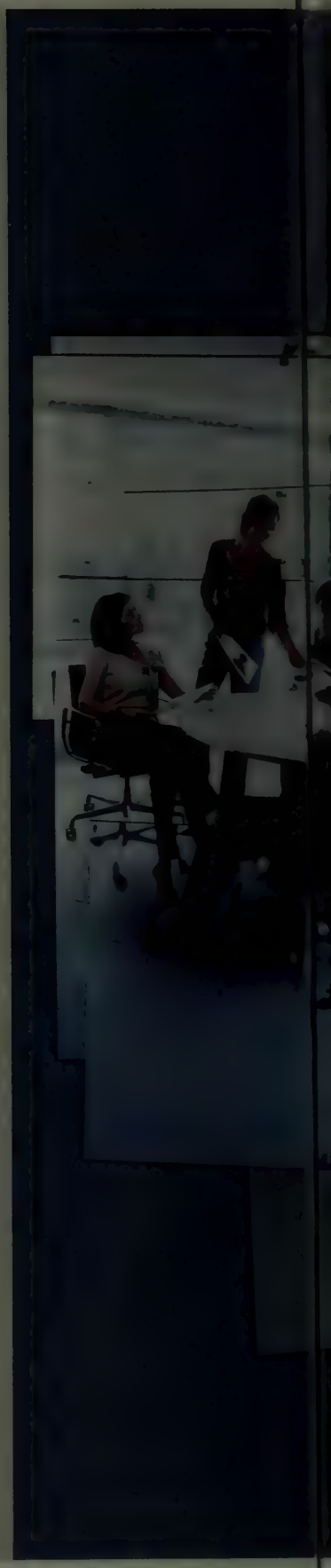

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Where the Boys Aren't

This is a tough column to write. It brings up clichéd assumptions of American males that I've rolled my eyes at for years. (Boys do poorly in school because they're too busy daydreaming about blowing things up; men forget how to read if there's a lighted screen within 100 yards.) But according to new research and top magazine executives, this much is clear:

Their medium increasingly skews toward women as men spend less time reading magazines.

"Women's interest in reading did not fall this year," says Ann Moore, chairman and CEO of Time Inc. But "we continue to see you men distracted by other things," she adds with a grin, as if I'm about to dash off to fire up a bunch of bottle rockets or spend hours, jaws clenched, blasting through *HALO*.

Research from Moore's company, the world's largest magazine publisher, finds a new, noticeable slide in men's magazine usage, while women's usage is holding steady. A mere five years ago there was no gender gap. Time Inc.'s research found that men spend more time with new media than women, which may account for the decline.

Thus the distortion of long-held media habits continues. Long term, Time Inc.'s data have implications for how magazines and other print media will reach male consumers. Right now, the findings put magazines at an increasingly familiar old-media disadvantage: searching for young men. This year, Hearst Magazines commissioned Keith Blanchard, a former editor of Dennis Publishing's *Maxim*, to create a prototype of a cheeky weekly lad magazine. This format is a smash hit in Britain via titles such as the (barely) double-entendred *Nuts*. But Hearst shelved the project. "All things that succeed in the U.K. are not necessarily a success in the U.S.," says Hearst Magazines President Cathleen Black. "Trying to build a strong franchise around men is tough." Attempts to bring the equivalent of one unalloyed recent hit—Condé Nast Publications' shopping title *Lucky*—to the boys have yielded mixed results. Its *Cargo* has yet to set the world aflame, and Fairchild Publications folded *Vitals Man* after barely a year.

THERE HAVE ALWAYS been gender lines in magazine publishing, but these days they're drawn more vividly. The big hits of this decade in terms of newsstand sales—the best barometer of consumer interest—have all been titles aimed at women: *Us Weekly* and the stampede of other celebrity weeklies, along with next-generation interpretations of women's service magazines, ranging from *O, The Oprah Magazine* to *Real Simple* to *Lucky*.

Maxim and the laddie titles it spawned are hardly in danger of disappearing, but their newsstand sales are far off their previous peak. Meanwhile, ad categories that gravitate toward men's titles, such as domestic automotive and technology, are down this year. Cosmetics and food categories, which turn up more in women's titles, are posting solid gains. *Advertising Age* has selected its "A-List" of 2005's top magazines, and, given all of the above, it shouldn't surprise that the top six are aimed at women. Time Inc.'s tough 2005 is almost wholly attributable to slow going at its major male-targeted titles, with *Time*, *Sports Illustrated*, and *Fortune* all posting double-digit advertising page dips.

Men aren't rejecting magazines—but they're drifting away from print

Some argue that it's not that men are disappearing so much as that there have been no breakthrough ideas since *Maxim*. To its credit, Time Inc. isn't relying on magazine-centric thinking. The best sign on its research is that men visit magazine Web sites more often than women do. In other words, men aren't migrating so much from the content of magazines as from the format. This would be better news if ad rates on the Web were as pricey as those in print. Still, "we're looking at a couple of things to launch that are not on paper," says Moore. "I don't think we are constrained by the delivery system." One project in development: a Web publication, aimed at young men, overseen by another former *Maxim* editor, Mark Golin. It probably won't be as much fun as blowing up aliens in *HALO*, but magazine executives have to start somewhere. ■

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The Barker Portfolio

BY ROBERT BARKER

Lend an Ear to Plantronics

From Surf City—that is, Santa Cruz, Calif.—to Milan's fashion runways may as well be from Ohio to the moon. Yet that's how far a low-profile company called Plantronics recently leaped. In 1969 its headset carried Neil Armstrong's first words from the lunar surface. This summer in Milan, Plantronics put on a fashion show—complete with pouty lips, swinging hips, and a Euro techno-beat—to present its latest line of headsets. These combine a microphone and earphone with Bluetooth wireless links for cell phones and MP3 players. Who knew something Mr. Spock might wear could come off so sexy?

Getting consumers to see its in-your-ear electronics as fashion objects is a major challenge now facing Plantronics. In August it launched its first full-scale marketing campaign, targeted at wireless gadget-laden professionals. We have yet to know how the campaign fares. But impatience at the cost is one reason investors have been dumping Plantronics' shares. After nearly touching 48 last fall, the stock recently dipped below 27, a level unseen since October, 2003.

THAT'S WHERE I SPY an opportunity. The reasons: Wall Street myopia, along with my own weakness for a company with a solid record of sales, earnings, cash flow, a sound balance sheet, plus an expanding patent portfolio. In 1961, Plantronics got its start making headsets for airline pilots. It still makes units for aviation and government use—but has added headsets for telephone call centers and cordless, mobile, and VoIP (Voice over Internet Protocol) phones. It also sells phones for the hearing-impaired and headsets for online computer gamers. Plantronics grew sharply in scale in August, when it closed a $165 million cash deal for Altec-Lansing Technologies, a veteran maker of high-end audio entertainment gear. With Altec-Lansing, sales this fiscal year, ending March, figure to rise almost to $700 million.

The clouds over Plantronics include the cost of—a worries about—the acquisition, the big ne marketing outlays ($1 million over a little m than a year), plus investments in China. Capital spending usua is 3% to 4% of sales; t year, it's running som 10%. Wall Street sees fiscal 2006 net income sinking to $80 million so, down from the $10 million Plantronics wo have earned in 2005 i had owned Altec-Lans through the period.

Year-over-year profi comparisons, however, are set to start looking much better in fiscal 2007, Plantronics' Chief Financial Officer Barbara Scherer told me. "We see tremendous long-cycle opportunities, she added, noting that the company expects long-term sal and earnings growth of 12% to 16%. A reason underlying t hope is innovation: Since 2001, Plantronics' patent portfol has more than doubled, to 111, including a dozen since last spring. One emerging market for Plantronics is VoIP phon a field where it has focused in part via a marketing partnership with Internet peer-to-peer phone service Skyp Technologies. Recently purchased by eBay, Skype has ties Plantronics rivals Logitech International and Sennheiser, t Plantronics also is intent on expanding sales of wireless headsets, such as those modeled in Milan, to businesses. It figures that if executives adopt wireless headsets, such as t Discovery 640 model that lists for $149.95 and can handle calls from a standard phone and a cell phone simultaneous they'll bring them to the office, sowing more demand there

Not all of Plantronics' initiatives will pay off. Yet it has a sturdy balance sheet, with more cash than debt. Plantronic pays a 20¢ annual dividend and in October announced a n share-buyback plan. With just three of nine analysts recommending the stock, according to Standard & Poor's Capital IQ unit, expectations are low. If, as the Street's consensus has it, Plantronics earns $1.99 a share in fiscal 2007, then its profit will have grown nearly 18% (table). Bu 29, the stock is selling for less than 15 times those earnings Do you hear that sexy techno-beat? ■

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Data: Capital IQ

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BY JAMES C. COOPER & KATHLEEN MADIGAN

Can Bernanke Please Two Masters?

He must win the bond market's trust and sell Congress on his policy ideas

U.S. ECONOMY Chairman Bernanke. It certainly has a different ring, doesn't it? Luckily for the economy, Wall Street seems to be adjusting well to the choice of Ben S. Bernanke to succeed the venerable Alan Greenspan as chairman of the Federal Reserve Board. Although the bond market first reacted to the news on Oct. 24 with some skepticism, stocks in the Dow Jones industrial average rallied to give the next Fed chief a 170-point vote of confidence. And why not? Bernanke had been the Street's expected choice for months, and his Senate confirmation will most likely be a breeze.

But it will be a short honeymoon. Bernanke takes over the Fed not only with new ideas on how to make policy but also at a crucial time for the economy. With inflation fears growing, policymakers are in the middle of a touch-and-go series of interest-rate increases that may well determine the fate of the current business cycle. The Bernanke Fed will have the task of deciding when to stop hiking. Overtightening policy could severely weaken growth in the economy, while undertightening could allow a broad pickup in inflation beyond the runup in energy costs.

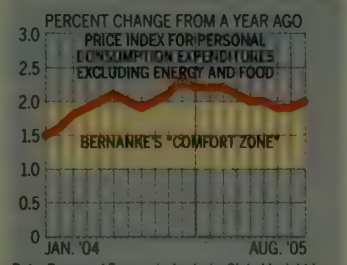
For now, the choice of Bernanke to lead the Fed has not altered the outlooks for either the economy or Fed policy. That much seems clear from the generally positive initial reactions of the markets and economic forecasters. The financial markets still expect the Fed's target federal funds rate to reach at least 4.25% by spring, up from 3.75% now. And based on the expectations implied in the market for interest-rate futures, investors continue to believe the funds rate has a high probability of reaching 4.5% by April.

STILL, THE FED NOMINEE'S most immediate job will be winning the trust of the bond market. The future path of long-term interest rates will be crucial to the outlook for housing activity and home prices. The degree to which housing cools off in the coming year will go a long way to determining how much the overall economy slows.

Treasury notes sold off across the maturity spectrum on Oct. 24, pushing yields higher. The move was widely interpreted as a sign that bond folk harbor some concerns that Bernanke may not have the same commitment to fighting inflation that Greenspan did. However, that was hardly a vote of no confidence. The selloff lifted the yield on a 10-year note by only 6 basis points, from 4.39% to 4.45%. By contrast, the day Greenspan's appointment was announced back in 1987, bonds plunged, pushing the yield up by 35 basis points, from 8.43% to 8.78%.

The perception that Bernanke could be soft on inflation is fueled partly by the Fed nominee's first years as a Fed governor from 2002 to 2005, when he was outspoken about both the risk of deflation and the need for very low interest rates or other extraordinary measures, such as the Fed's purchasing of Treasury securities, to insure against it. Some in the bond market seem unsure about whether Bernanke's concerns over rising and falling prices are symmetrical.

INFLATION: CROWDING THE 'COMFORT ZONE'



Data: Bureau of Economic Analysis, Global Insight Inc.

They might be in for a surprise. The bond selloff on the appointment news represents "an uninformed view of Ben Bernanke," says Roger M. Kubarych, senior economic advisor at HVB Group in New York. That's because Bernanke is at least theoretically committed to inflation-targeting. That is, the Fed should adjust interest rates to keep inflation within a given range. By definition, says Kubarych, an inflation-targeter will be just as diligent on the upside of that range as on the downside. Keep in mind that Bernanke, not shy to speak his mind, voted for the Fed's first seven rate hikes without dissenting, before his departure from the board earlier this year.

BERNANKE SOON MAY GET an opportunity to prove his inflation-fighting mettle. In a speech in Chicago in March, the then-Fed Governor forecasted that in 2005 the Fed's preferred measure of inflation—the price index for personal consumption expenditures excluding energy and food—would likely remain in what Bernanke called his "comfort zone of 1% to 2%." In August, inflation already stood at his upper limit of 2%, and the expected pass-through of higher energy costs seems likely to push that gauge above 2% by next year (chart).

For one reason, despite the buffeting from higher energy prices and hurricanes, the economy continues to plow ahead. The National Association for Business Economics' latest Industry Survey, taken on Oct. 4-14,

shows strong demand, good profit margins, and solid capital spending plans. It also offered more evidence that inflation is on the rise. The net percentage of companies reporting higher prices for both the materials they purchase and the products they sell rose to 38%, the second highest in the survey's 24-year history (chart).

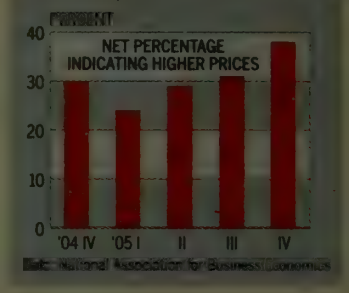
But while Bernanke is committed to the theory of inflation-targeting, he is unlikely to try to rush those ideas into policymaking practice anytime soon. It's not simply that the strategy faces opposition on the Board. It will also be a tough sell to Congress, which has given the Fed a dual mandate, not only to control inflation but also to promote maximum sustainable economic growth. That means Congress is likely to weigh in on any debate over formalizing any targeting scheme, and Bernanke will be careful to protect the Fed's independence.

Already, Senator Paul S. Sarbanes, ranking Democrat on the Senate Banking Committee, which will hold hearings on the nomination, has raised a question on the issue. After Bernanke's pledge to "maintain continuity" with previous policies, Sarbanes told Bloomberg News in an interview on Oct. 24, "How will you sustain continuity when you've enunciated a principle that chairman Greenspan has been unwilling to accept?"

BERNANKE'S ANSWER lies in his framework for inflation-targeting, which he laid out in two speeches in February and March, 2003, a framework that will very likely guide his approach to policymaking. He calls the strategy "constrained discretion." Contrary to most accounts, Bernanke's approach is not a strict rules-based system that says the Fed must pick a target and stick to it come hell or high water.

As he put it two years ago, "constrained discretion attempts to strike a balance between the inflexibility of strict policy rules and the potential lack of discipline and structure inherent in unfettered policymaking discretion." That means, in case of extraordinary circumstances, the rules can be bent to accommodate the policymakers' best judgment. Bernanke goes so far as to say that the paradigm "describes reasonably well the recent policy approach of the Federal Reserve," except without the publicly announced inflation target.

MORE BUSINESSES REPORT RISING PRICES



The real trick for Bernanke will be to sell his policy ideas to both Congress and the bond market, each with competing priorities. Congress wants assurance on growth and jobs, while the bond market has a cold eye on inflation. In the coming year, both groups will be struggling to get a handle on the balance between how much constraint Bernanke's Fed will enforce in its rate setting decisions and how much discretion it will allow along the way. ■

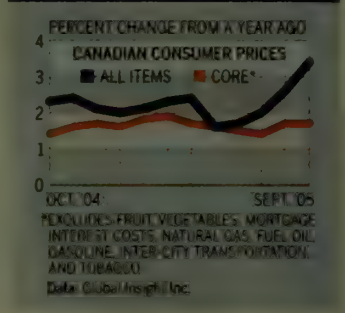
CANADA

The Forecast: Low Visibility on Rates

THE BANK OF CANADA will have its hands full navigating monetary policy in the coming year. The economy is running fast enough to lift inflationary pressures. But the BOC is concerned about a slowdown in global growth later down the road.

In the October update of the *Monetary Policy Report*, the BOC cut its 2006 economic growth forecast to 2.9%, from 3.3%, but said price pressures have risen. Economic growth in the first half of the year was stronger than anticipated and now has the economy "operating at full production capacity." Already-high capacity utilization rates in energy and mining are rising, and more companies are reporting labor shortages. As a result, even slower growth can still spark inflation.

PRICE PRESSURES ARE MOUNTING



Labor productivity gains far below the BOC's long-run expectation of 1.75% per year add to potential price pressures. After stagnating in 2004, productivity rose 0.7% from a year ago in the first half of 2005. The central bank acknowledges the sluggish pace but expects a recovery.

Increasing capital investment should help make workers more efficient, but any pickup in productivity will be gradual. Goods and services productivity growth, which includes the hot construction and energy sectors, lags far behind ailing manufacturers.

The data validate a more hawkish stance. September consumer prices rose 3.4% from a year ago. Less food, energy, and other volatile items, prices were up 1.7%. Core inflation is still below the central bank's 2% target, but the BOC expects it to rise. August retail sales fell 0.3%, but sales of home goods were solid. Consumers in Western Canada benefiting from the commodities boom are spending in droves. Commercial construction is also taking off just as the housing market may be peaking.

The central bank knows the current overnight rate of 2.75% is too low. At the same time, it is concerned about slower global growth and weaker foreign demand in 2007. That means rate hikes will keep coming in quarter-point increments. But the BOC may have to raise rates well into 2006 in order to stay ahead of inflation—no matter what is lurking off in the distance. ■

-By James Mehring in New York

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AFTER GREENSPAN

THE NEW FED

Why Greenspan successor Bernanke will preside over a diminished central bank

BY RICH MILLER

WELCOME TO THE ERA OF THE DIminished Fed. For more than 25 years, Main Street and Wall Street have stood in awe of America's central bankers, the mythic figures who chaired the Federal Reserve. Paul A. Volcker, Fed chairman from 1979 to 1987, battled the dragon of double-digit inflation, besting it at the cost of a deep recession. Alan Greenspan, in turn, was lauded for his rapid response to the stock market crash of October, 1987, shortly after taking office as chairman. Later he fought off the effects of the Asian financial crisis of 1997 and dampened the damage from the tech bust and the terrorist attacks of September 11. Not for nothing was he called the second-most powerful man in the world.

The Fed itself was far more powerful than any other central

DAVID SCULL

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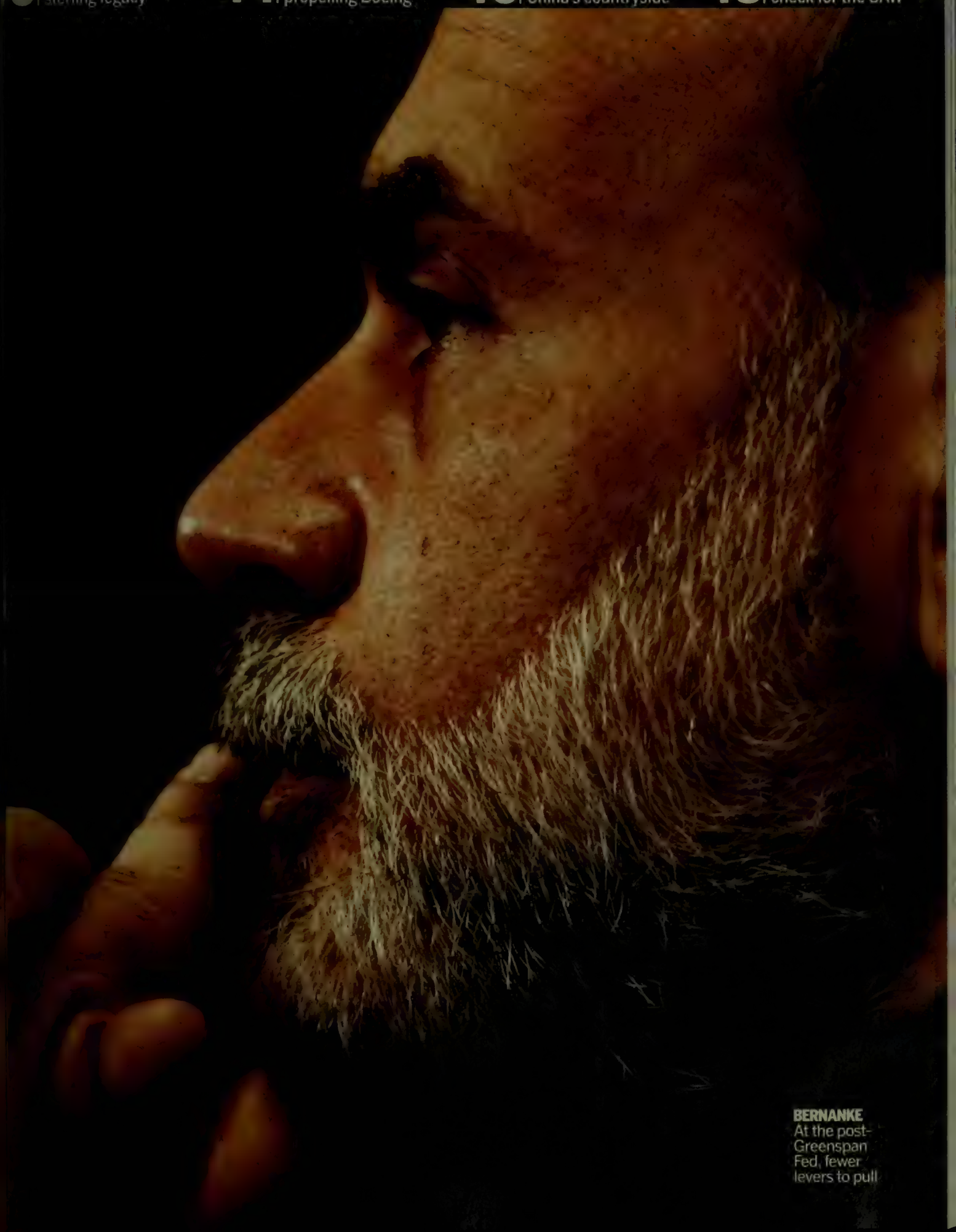
46 Dell stumbles in China's countryside

48 Commentary: A reality check for the UAW



BERNANKE
At the post-Greenspan Fed, fewer levers to pull

bank. Interest rates around the world followed its lead. Backed by the dominance of the U.S. economy, the Fed was able to flood the world with dollars when financial disaster threatened. And the institution's influence was magnified by the attention and respect given its leader.

But the time of the heroic central banker and the all-powerful central bank is coming to ar. end. If the incoming Fed chairman, Ben S. Bernanke, has his way, monetary policy will depend much less on the force of will, keen economic insights, and other exceptional qualities of the Fed's chief. Instead, Bernanke will move the Fed toward clear and coherent rules for hitting publicly announced inflation targets—an operating style that he calls "constrained discretion."

At the same time, the increased importance of international financial flows will make it much harder for the Fed to have the clout, both at home and abroad, that it once did. In particular, the dependence of America on foreign investors to fund its massive trade deficit puts the country in a far weaker financial position. "That's the big difference from when Greenspan took over," says Robert Hormats, vice-chairman of Goldman Sachs International Corp.

DOWN FROM MOUNT OLYMPUS

As Ben Bernanke takes office, the Fed is likely to become a humbler institution

SHRINKING GLOBAL CLOUT Emergence of stronger markets abroad, coupled with heavy U.S. dependence on foreign capital, limits the Fed's freedom of action and reduces its impact on the global economy.

TYING HIS OWN HANDS Bernanke strongly favors setting an announced target range for inflation. If he follows through, the Fed's policy steps could become more mechanical, leaving less room for discretionary action.

TAKING DOWN THE CURTAIN Bernanke helped push greater openness about the Fed's actions and intentions, including publication of its longer-term economic forecasts. Further glasnost would demystify the central bank and open more debate on its decisions.

USING THE LATEST MODEL Unlike Greenspan, who reveled in obscure data, Bernanke relies heavily on economic models for forecasting. By tracking the same models, Wall Street should have a better handle on where the Fed is going.

CLOSING THE OPEN-MOUTH POLICIES Greenspan, a long-time GOP adviser, used his clout to influence debates on taxes, spending, and retirement policy. Bernanke, a monetary specialist with a scant policy record, is less likely to speak out.

"DEPERSONALIZING" MONETARY POLICY

SO BOTH OUT of choice and out of necessity, Bernanke is going to preside over a diminished Fed. In fact, he's one of a worldwide group of top monetary economists who have concluded that the right thing to do is to shrink the scope of central banks everywhere and get them back to their mission of fighting inflation. "Having the central bank get into issues that really are not issues of the central bank is a mistake," says Columbia University Graduate School of Business professor Frederic Mishkin, a former senior official at the New York Fed and a co-author with Bernanke of some seminal articles on inflation targeting. And depending on rules—not the insights of individual policymakers—will produce better results, he adds. "Depersonalization of monetary policy is a good thing."

In many ways, the urge to reduce the discretion of the Fed, although shared by economists of differing political persuasions, is broadly analogous to the conservative drive to limit the activism of judges. In both cases, advocates see the same advantages: more predictability and less uncertainty. Not surprisingly, the choice of Bernanke is strongly supported by conservative icon and Nobel Prize winner Milton Friedman. "I think he's an able n who has the right about monetary p Friedman told *Bu Week*. "The worst you can have is a ranging Fed."

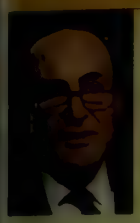
Of course, the Fe der Bernanke wil have all of its vast ers—the ability to dollars at will, regu clout over banks, an trol over short-term est rates. The Feder serve building will s a massive landma Washington. And th eral Reserve Bank i York, not far from th of the World Trade C will still house the w largest accumulatio gold, much of it stor foreign governments

Bernanke may als that his vows of restraint will be mo ficult to keep once he ting in the chair spot at the big confe table. If he's faced fast-developing fin crisis—like Gree was in 1987 wher stock market crashe months after he too fice—Bernanke may find himself forced to take an activis "Monetary policy is always going to be central, and the a to sustain global confidence will be even more important future than it has been in the past," says Lawrence H. mers, president of Harvard University and Treasury Sec under President Bill Clinton. "Much of that responsibili maintain confidence] rides with the Fed."

Still, at least at first, Bernanke will cut a smaller figure o national and global stage. He is one of the top economists generation, and he has a wry, self-deprecating wit, frequ directed at his unfashionable clothing. He's also known good listener and consensus builder. However, he doesn't the depth of Washington experience that Greenspan had taking office. Nor does he have Greenspan's extensive Street or corporate ties. That means Bernanke, 51, lacks th of innate feel for the rhythms of the financial markets and ness that only comes with experience. Moreover, as an demic he concentrated his research on monetary policy an not stray into more partisan fields such as entitlements sp ing and tax cuts. He'll try to keep that single-minded fo the central bank. That could undercut his influence in the ital, long used to Greenspan's penchant for commentin anything economic.

Even if Bernanke wanted to become a heroic central ba he will find that the financial markets no longer respond so For the past 16 months, the Fed has relentlessly raise overnight interest rate that it controls, which in the past w

THE BUZZ ABOUT BERNANKE



"He was far and away Wall Street's first choice. Of all the [candidates], he was closest to the Greenspan mold. He's not an ideologue."

CHARLES SCHUMER
Senator (D-N.Y.)
Senate Banking Committee

"He's the best choice of the many names that were mentioned. I'm kind of surprised they chose him. Generally speaking, they haven't had perfect pitch in their appointments."

PAUL SAMUELSON,
Nobel laureate, MIT

"Ben Bernanke is clearly a pro-growth economist, and that is encouraging for the country's economic future."

G. KENNEDY THOMPSON
CEO, Wachovia

have pushed up long rates and slowed the economy. Yet rates on 10-year Treasury notes are largely unchanged (chart), suggesting that the flow of funds into the U.S. from China, Japan, and Europe is overwhelming the Fed's actions.

LESS SHOOTING FROM THE HIP?

THE NEW CHAIRMAN MAY also feel constrained in the area of crisis fighting, a key priority for the Fed. In past crises, Greenspan could act independently, backed by the most powerful central bank in the world. But now, with nearly half of U.S. government debt held overseas, Bernanke may be forced to seek help from foreign central banks, among the biggest investors in U.S. Treasury securities, in managing a crisis.

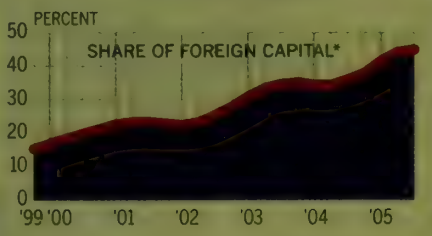
Meanwhile, Bernanke's commitment to public inflation goals is likely to slow the Fed's adjustment to sudden and unexpected changes in the economy. Take the productivity surge which began in 1996 and 1997. Back then, most forecasting models were predicting inflation would accelerate. That would have led an inflation-targeting Fed to boost rates or run the risk of losing credibility with the markets. Greenspan, recognizing that as-yet-unmeasured productivity growth would mute price hikes, held rates down, a move which helped fuel the New Economy boom.

In general, it may become harder for the Fed to make moves that appear to contradict its inflation targets. "If we have something like September 11 again, the main thing you're trying to do is to restore public confidence," says a Fed policymaker who is against inflation targeting. "I sure wouldn't want to be caught having to think about a price stability target."

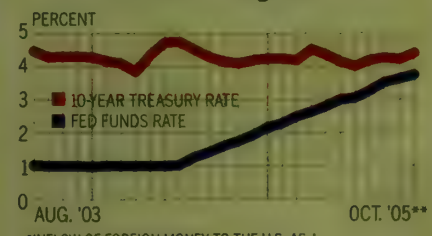
In some ways it's a little bit surprising that the urge to rein in the Fed's discretion should arise now. After all, Greenspan has been widely applauded as the best central banker ever. During his 18 years as Fed chairman, investors from Sydney to São Paulo hung on his every word, looking for hints of changes in interest rates and reassurance on the health of the U.S. and world economies. And as the economic answer to the Oracle of Delphi, Greenspan was avidly sought for his views on topics well outside the Fed's purview, from Social Security reform to the price of natural gas.

LOSING CONTROL

America's growing dependence on foreign capital...



...helps explain why Fed hikes haven't moved long-term rates



*INFLOW OF FOREIGN MONEY TO THE U.S. AS A PERCENTAGE OF DOMESTIC SAVINGS
**AS OF OCT. 24. OTHER RATES ARE MONTHLY AVERAGES

Data: Federal Reserve, Bureau of Economic Analysis

But despite Greenspan's success and prominence, many economists and Wall Streeters felt a vague discomfort with the way he handled monetary policy. "He has become increasingly seat-of-the-pants, which carries a lot of problems," says Jim O'Neill, head of global economic research at Goldman Sachs in London.

That's why economists as diverse as liberal Alan S. Blinder and conservative Friedman support Bernanke in moving to inflation targeting. Under this scheme, when forecasts predict that the rate of inflation is going to stray outside the Fed's target band, the central bank would defend its goal with hikes or cuts in short-term interest rates. Bernanke has described his inflation comfort zone as a 1% to 2% annual increase in prices, excluding food and energy costs.

Equally important to Bernanke's vision is clear communication of the Fed's goals and strategies to the markets. This is meant to increase the predictability of the economy and markets for investors and companies, making decision-making easier. "Bernanke appears to lean toward trying to take some of the shooting from the hip out of Fed policymaking," says David A. Lereah, chief economist of the National Association of Realtors.

Supporters of this strategy argue that a diminished Fed would still be able to get the job done. Indeed, in a crisis it would respond by flooding the markets with enough cash to prevent a financial system meltdown. Likewise, advocates of a restrained Fed say it wouldn't hesitate to cut interest rates and spur economic growth if deflation loomed. As evidence, they point to the leading role that Bernanke played in the Fed's decision in mid-2003 to push rates down to the rock-bottom level of 1%, and keep them there for a year, to guard against a deflationary downturn.

However, if the economy is faced with ordinary muddles, rather than sharply defined crises, Bernanke's Fed is more likely to err on the side of restraining inflation. "If you have a publicly announced inflation target, you're going to be a little bit embarrassed if you miss it," says Johns Hopkins University professor Laurence Ball, who has written extensively on inflation. "That's at some level going to put pressure on policy-

makers to put a little too much emphasis on reducing inflation."

The Bernanke Fed also could be slower to react when the housing boom ends. If the housing market does start to fall sharply, the Fed must decide whether to slash rates to cushion the economy. Under Greenspan, that move would come as second nature. An inflation-targeting Fed, however, would be constrained from acting until it was convinced that the housing bust would drive inflation below its target range. Only then could Bernanke and Fed policymakers decide to cut rates and by how much.

Bernanke insists he will guard the flame of Greenspan-style policymaking. Flanked by Greenspan and Bush at the Oct. 24 White House news conference announcing his nomination, he pledged to "maintain continuity with the policies and policy strategies established during the Greenspan years." Nevertheless, the Bernanke Fed is one that, for better or worse, is likely to be different and less grand than the Greenspan Fed. ■

–With Paul Magnusson in Washington, Peter Coy in New York, William C. Symonds in Boston, Laura Cohn in London, and bureau reports

Bernanke: A New Era at the Fed

No White House Yes-Man The President may be comfortable with Ben Bernanke's views. But the incoming central bank ch is known as a stickler for Fed autonomy

Answers About Ben Bernanke S&P Chief Economist David V fields the questions bouncing through many investors' minds

Covering the Greenspan Era A slide show on how *BusinessW* reported the career of the outgoing Fed chairman

Bernanke on the Record Comments on key topics, including inflation targeting and deflation

The Story Behind the Story For a podcast interview with Chief Economist Michael Mandel by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

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FED POLICY

What's the Fuss Over Inflation Targeting?

The biggest policy difference between Alan Greenspan and Ben S. Bernanke is over something known as inflation targeting. Greenspan is against it, Bernanke is for it. Here's a guide to understanding the debate.

What is inflation targeting?
It's a policy of announcing what you're going to do, and then doing it. Either the central bank or the elected government chooses and publicizes a target goal for the inflation rate—say, 2% a year. The bank then publicly estimates how high it expects inflation to be in the coming year. It steers monetary policy to try to hit the target inflation rate. If inflation is getting above the target, the bank would ordinarily raise interest rates to cool the economy and bring inflation back down. If inflation gets too low, the bank would lower rates to juice up growth, raising inflation.

Where is this approach in use?
It is the official policy of Britain, Canada, Australia, Sweden, New Zealand, Brazil, and South Korea, among others.

Is it working for those countries?
Apparently so. According to a Goldman, Sachs & Co. study in June, countries that implement inflation-targeting policies tend to stabilize their inflation rates while keeping economic growth on an even keel. The study found that the U.S. and Japan, which don't have formal targets, have more volatile stock and bond markets—perhaps indicating more investor uncertainty about the direction of inflation.

Why does Bernanke favor inflation targeting?
He thinks that a more "transparent" Federal Reserve policy would promote stable, non-inflationary economic growth by giving businesses and consumers more certainty about the future course of intere rates and inflation.

Why is Greenspan against it?
He thinks the Fed can control inflation without announcing a target rate. Plus, he worries that an announced rate would ma it harder to respond flexibly and intuitively a financial crisis or changing economic conditions. Greenspan recognized from a variety of subtle indicators in 1997 that ra productivity growth was likely to curb inflation—even though most conventional forecasts predicted accelerating inflation. He persuaded fellow Fed policymakers to not raise interest rates, allowing the economy to flourish.

Does Bernanke admit that inflation targeting would decrease the Fed's flexibility?
No. He says that in a crisis the Fed would do whatever it takes to stabilize the economy. Frederic Mishkin, a Columbia University economist and longtime Bernanke collaborator, says that establishing credibility with the financial markets as an inflation hawk gives an inflation-targeting central bank more, not less, flexibi to tackle recessions.

–By Peter Coy in New Yor

Greenspan thinks target rates would hamper Fed flexibility

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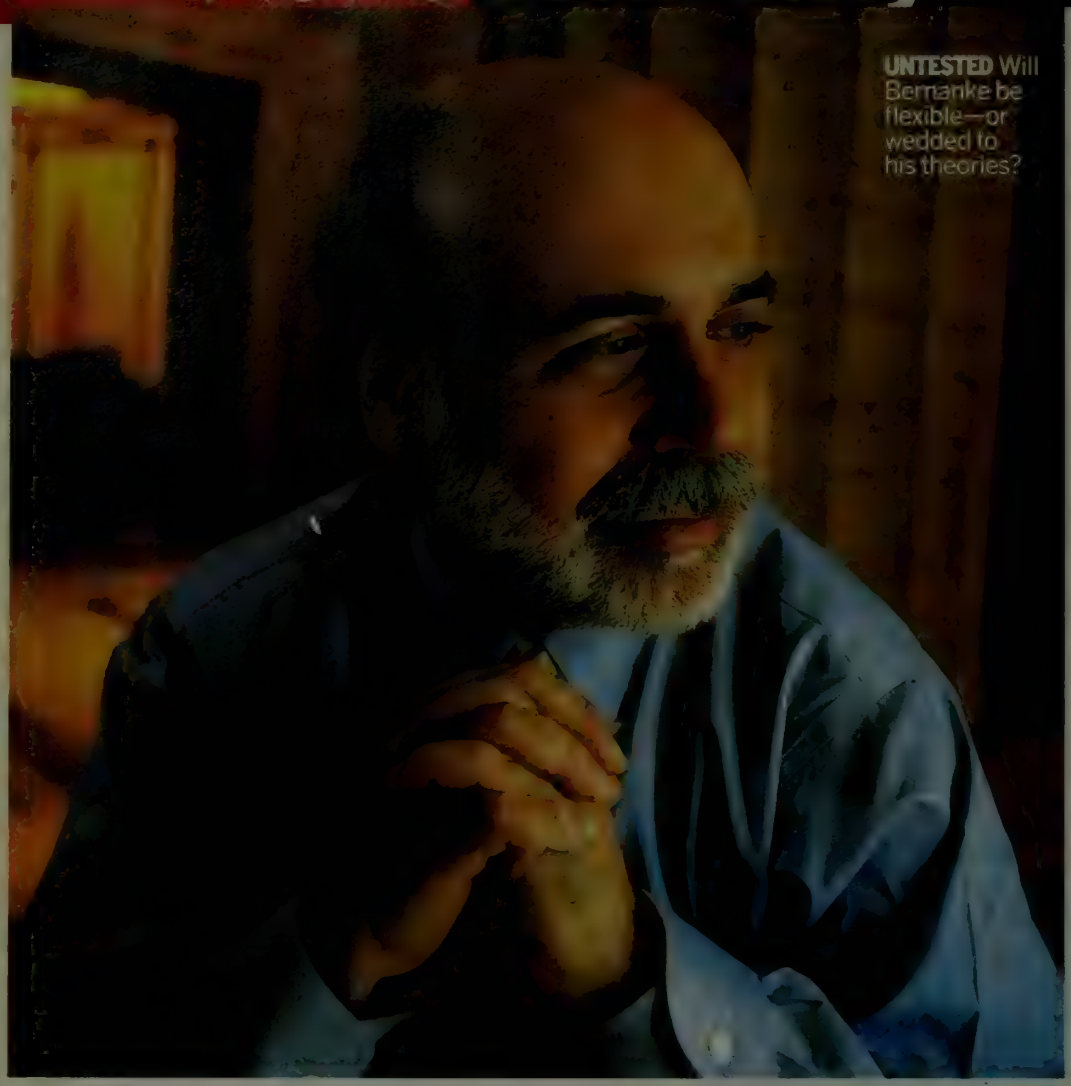

UNTESTED Will Bernanke be flexible—or wedded to his theories?

THE SUCCESSOR

THE ASCENT OF GENTLE BEN

Bernanke is a conciliator, but a new, wider audience will be tougher to please

EVERY OTHER MONDAY MORNING, THE GOVernors of the Federal Reserve gather around a massive mahogany table to discuss the nation's economic health and the state of the banking system. During the three years that Ben S. Bernanke attended those sessions, a routine developed. The former Princeton University economics professor would start quizzing Fed staffers on the deeper meaning of the data. More often than not, before an aide could get a word in, Fed Chairman Alan Greenspan would offer his own elegant explanation. Bernanke would listen attentively, then quietly say: "Be that as it may... I'd still like the staff to get back to me."

The scene played out so often that some Fed officials came to joke about Bernanke's "be that as it may." As a neophyte central banker from 2002 to 2005, Bernanke never challenged Greenspan's authority. Yet he never backed down in his quest for more data and differing views. Eventually, he would get both the information he wanted and the chairman's respect.

COLLEGIALITY

NOW, HE'S ABOUT to get Greenspan's job. On Oct. 24, President George W. Bush named Bernanke to chair the Fed when the 79-year-old Greenspan retires on Jan. 31. Fed colleagues say that Bernanke owes his swift rise from chairman of Princeton's economics department to the threshold of the world's most eminent economic-policy job to his knack for getting along with intellectual heavyweights through a combination of professional rigor and collegiality.

But other skills, untested during his years in academia and three years in Washington, could prove even more vital. Wall Street's Fed watchers wonder whether an academic like Bernanke will be flexible in responding to the economy or wedded to his own theories and mathematical models about the way the world works. They also fret that Bernanke has never been tested in a crisis—an area where Greenspan triumphed throughout 18 years at the Fed. The low-key Bernanke did not come off particularly well when, as chairman of Bush's Council of Economic Advisers (CEA), he tried to soothe the markets' frazzled nerves in the wake of Hurricane Katrina. "He lacks a commanding presence in front of the camera," says David Gilmore, partner at consultants Foreign Exchange Analytics in Essex, Conn. Even in private briefings at the White House, one Administration insider concedes, the President's chief econo-wonk did not always display the crisp certitude that political types favor.

Bernanke's greatest strength will be his intellect. Considered one of the finest monetary economists of his generation, the 51-year-old Bernanke can hold his own on the minutiae of credit flows and inflation expectations. But unlike most economists, Bernanke can translate those arcane concepts to the real world, without seeming to talk down to people. "In the academic world, you can develop lots of sound ideas, but you have to convert those into policies," says former Commerce Secretary Donald L. Evans, now CEO of the Financial Services Forum. "He has been able to bridge the two." That skill, coupled with a wry, self-deprecating wit, won over President Bush during Bernanke's 17-month stint as CEA chairman.

Bernanke's smarts were on display as far back as sixth grade, when the 11-year-old won the South Carolina state spelling bee. Like Greenspan, he came to love statistics by studying baseball

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box scores: A longtime Boston Red Sox fan, he cut classes in 1975 to listen to the World Series. The son of a druggist and a schoolteacher, he taught himself calculus, then went on to score 1590 of a possible 1600 on his SAT college boards to win admission to Harvard University. After graduating *summa cum laude* with a degree in economics, he earned a doctorate from Massachusetts Institute of Technology in 1979 and opted for the academic life, teaching at Stanford University before settling at Princeton in 1985.

Bernanke made his academic mark with research on the Fed's role in causing and prolonging the Depression. He eschewed the esoteric to focus on topics that could have relevance for policymaking. "It's the guiding principle in his work," says New York University professor Mark Gertler, who wrote several papers with Bernanke. "Anything we did had to be connected to the real world."

Yet Bernanke's own politics didn't come through in his research. Princeton colleague Alan S. Blinder, appointed by Bill Clinton as Fed vice-chairman for 1994-96, was unaware for years of his friend Bernanke's GOP leanings.

CALM CONSENSUS

WHAT SETS Bernanke apart from many other academic economists is his ability to forge consensus. Those skills emerged when he joined the Montgomery Township (N.J.) school board in the mid-1990s, and calmed its contentious relations with teachers through two contract negotiations. He spent seven years chairing Princeton's powerhouse econ department, muting his own politics to manage a largely liberal group. Describing that job in a speech earlier this year, Bernanke joked that he had "responsibility for major policy decisions such as whether to serve bagels or doughnuts at the department coffee hour."

That ability to puncture his own importance helped Bernanke win admirers at the Fed, including Greenspan himself. Before Bernanke arrived, the chairman worried that he was in for a repeat of his prickly experience with Blinder. Those concerns proved misplaced. Bernanke did persistently push his view that the Fed should establish a numeric target for inflation—a stance that Greenspan opposes in favor of a more flexible approach. But he did so gently, seeking to build support among fellow governors and avoiding confrontation with Greenspan. "They always had a good back-and-forth on that and other issues," a Fed official says.

Moving to Washington entailed sacrifice. In the capital, Bernanke griped, he was expected to wear a suit every day. "My proposal that Fed governors should sign their commitment to public service wearing Hawaiian shirts and Bermuda shorts has so far gone unheeded," he told a group of economists last January. His wife, Anna, formerly a parochial school teacher at Princeton Day School, has recently moved to the National Cathedral School. She missed Bernanke's confirmation hearings for the Chairmanship because she was giving her seventh graders an exam. Their two children, Alyssa and Joel, are in college.

But little changed in Bernanke's style when he moved from academia to the world of policy. He lunched in the staff cafeteria, joining aides for impromptu skull sessions. The ex-academic also wowed staffers by rarely using his own speech as a digging into spreadsheets for data.

Bernanke also went out of his way to cultivate fellow governors. He formed close ties with two Greenspan protégés, staffer-turned-Governor Donald L. Kohn and Federal Reserve Chairman Roger W. Ferguson Jr. Even after long discussions, neither Kohn nor Ferguson was won over to Bernanke's idea of setting inflation targets.

As he prepares for a scheduled Feb. 1 ascension to the top job at the Fed, Bernanke's confirmation is considered pro forma on Capitol Hill. But the brainy economist will then have to take his case for targeting inflation to a much broader, and arguably tougher, audience: Wall Street, Main Street, and the world. The other central bankers will all want to see if Gentle Ben has the vision and the street smarts to succeed a monetary master like the likes of Alan Greenspan. ■

–By Rich Miller, with Richard S. Dunham, in Washington

HIGH SCHOOL YEARBOOK Bernanke (right) was deemed "most likely to succeed"

Most Likely to Succeed: Anna Traywick, Ben Bernanke.

BIO

Ben S. Bernanke

The Fed nominee's ability to puncture his own importance has won him many admirers.

BORN Dec. 13, 1953, in Augusta, Ga. Father a pharmacist; mother a teacher

EDUCATION Harvard College, B.A., *summa cum laude* in economics, 1975; Massachusetts Institute of Technology, PhD in economics, 1979

CAREER Taught economics at Stanford University, 1979-85; Princeton University, 1985-2002. Chaired Princeton's economics department, 1996-2002

ECONOMIC CREDENTIALS Known for his studies of how the Federal Reserve's miscues had the effect of worsening the Great Depression. Member of the National Bureau of Economic Research's recession-dating committee.

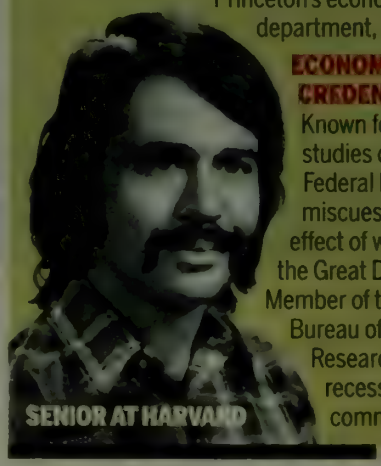
POLITICAL EXPERIENCE, PRE-WASHINGTON As member of the Montgomery Township (N.J.) school board, led two contract negotiations with teachers.

POLITICAL EXPERIENCE, WASHINGTON Named to the Fed's board in 2002 by President Bush. Has chaired Bush's Council of Economic Advisers since June.

WHAT CHANGED WHEN HE CAME TO WASHINGTON "People seem to find my ideas and insights of greater interest—although, so far as I know, I have not become any smarter."

RELAXING Plays basketball—and roots for the Washington Nationals (after a quarter-century of supporting the Boston Red Sox).

FAMILY Wife, Anna, teaches Spanish at a private school; two children, Alyssa and Joel.



SENIOR AT HARVARD

Data: Federal Reserve, White House, Associated Press, BusinessWeek

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LOOKING BACK

GREENSPAN'S RICH LEGACY

He nurtured booms, cushioned busts, and saw what others did

WHEN ALAN GREENSPAN TOOK CHARGE of the Federal Reserve in August, 1987, businesspeople and economic cognoscenti thought they knew what they were getting: a dedicated—even obsessive—inflation fighter who would be willing to provoke a recession to hold down prices. As one Republican told *BusinessWeek* at the time, Greenspan "feels in his bones that austerity is good for you."

Eighteen years later, as Greenspan comes to the end of his long tenure as Fed chairman, his rout of inflation is almost unquestioned. Taking out volatile energy and food prices, consumer inflation is still running at 2%, compared with a 3.9% rate when he came into office. By any standard, that is a splendid performance.

But history is likely to celebrate Greenspan for another achievement: his ability to steer the U.S. economy successfully through the white-water ride of the past decade. Through it all—tech boom, Asian financial crisis, stock market bubble, tech bust, recession, Enron, terrorist attacks, and a housing boom—Greenspan's hand guiding monetary policy w u paralleled. "Alan Greenspan has a deeper economic int tic than almost anybody I've ever met," says Glenn Hubbard de of the Columbia Business School and former chairman f t Council of Economic Advisers under President George W us as well as a *BusinessWeek* columnist. Adds Richard M. K ac vich, chairman and CEO of Wells Fargo & Co.: "I think h w go down as perhaps the best central banker of all time."

NEW ECONOMY VISIONARY

BASED ON TODAY'S ECONOMIC STATISTICS, there is litt re son to doubt this evaluation. Unemployment is lower ha when Greenspan became Fed chairman, productivity gro th nearly a full percentage point faster, real wages are highe an the stock market has more than doubled, even after adj tin for inflation (table). "Greenspan created the environm t which business could thrive," says Charlie Giancarlo, the hi development officer at Cisco Systems Inc. and a possibl su cessor to CEO John Chambers. "We used to think that 1% 2 was normal economic growth. Now we consider 3%-plus o normal growth. That's a huge accomplishment."

In retrospect, Greenspan's philosophy of central bankin w

A SHORT HISTORY OF AN EVENTFUL ER

JUNE 15, 1987 *BusinessWeek*'s first cover story on Greenspan

AUG. 11, 1987 Greenspan takes office as chairman of the Federal Reserve, succeeding Paul Volcker.

JULY 31, 1989

AUG. 2, 1990 With the U.S. economy already soft, Iraq invades Kuwait, and oil prices zoom. The Fed cuts rates by three percentage points over two years.

NOV. 3, 1992 President George H.W. Bush loses reelection campaign to Democrat Bill Clinton. Bush supporters later blame Greenspan's high interest rates for his defeat.

1994-95 Fed tightening caus a severe bear market in bond The federal fun rate doubles, from 3% to 6%

1987 1988 1989 1990 1991 1992 1993 1994 1995

OCT. 19, 1987 The Dow Jones industrial average falls 23%. The next day, Greenspan ignites a recovery by promising to lend freely to distressed institutions.

FEB. 24, 1989 Determined to stamp out inflation, the Fed raises the federal funds rate to just shy of double digits: 9.75%.

JULY, 1990 With credit tight, the U.S. economy slips into a mild recession that lasts until the following March.

simple: ride the booms, cushion the busts. Belying his reputation as an austere inflation hawk, Greenspan was one of the first economists to embrace the notion of a technology-driven productivity boom in the second half of the 1990s—the so-called New Economy. His willingness to keep rates low despite criticism from inside and outside the Fed helped fuel business investment and growth.

Then, in 2001, when the stock market tanked, the tech boom turned to bust, and terrorists attacked on September 11, Greenspan cut rates at a rocket pace, going from 6.5% to 1.75% in just one year. The result: Rather than cratering, as most economists expected, growth has averaged a solid 3.2%, and productivity has risen at an amazing 3.5% rate. Greenspan can't be given all the credit, but his willingness to slash rates aggressively may have helped the economy avoid a deep downward spiral.

There are plenty of economists who suspect that Greenspan's legacy will not be quite so positive. Some blame him for lollygagging on the sidelines during the stock market's wretched excesses of the 1990s. "He should have shot something across the bow of the bubbly crowd," says Nobel prize winner Paul A. Samuelson of the Massachusetts Institute of Technology.

Others fear that Greenspan's rate cuts may have led to a housing bubble and an excess of debt. "Investors and consumers of housing simply believe that if things get too tough and prices fall too far, the maestro will ride to the rescue once again," says William H. Gross, chief investment officer at Pacific Investment Management Co., the world's largest bond manager, with $513 billion in assets. "That approach, in the long term, is destabilizing. It promotes speculative activity." Observes Jean-Paul Betbèze, chief economist at Crédit Agricole, the largest bank in France: "In my opinion, Greenspan's legacy is an imbalanced America—imbalanced in terms of personal savings, in terms of national financial stability, and in terms of the housing boom."

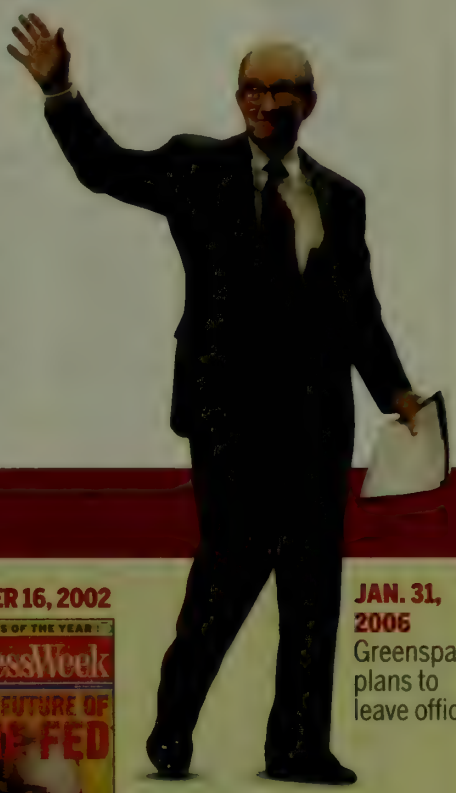
Many Democrats criticize Greenspan's support for the Bush tax cuts. It "was completely inappropriate," says Robert B. Reich, Brandeis University professor and Labor Secretary under President Bill Clinton, noting that the tax cuts "have contributed mightily to our present mess."

Still, for all the handwringing, the national debt burden, at 204% of gross domestic product, is not very much higher than it was when Greenspan took office. The massive jumps in energy prices show no sign of spreading to the rest of the economy, and corporate profitability remains high.

DEFYING SKEPTICS

WHAT'S MORE, THE PESSIMISTS HAVE to contend with the simple fact that Greenspan's track record at forecasting economic performance has been consistently far better than theirs. Today it's accepted wisdom that the tech-driven acceleration of productivity growth started in 1996 or 1997. But back then, official statistics were ambiguous, and few professional economists outside or inside the Fed shared Greenspan's view that information technology had broken a two-decade productivity drought.

Indeed, the skepticism persisted for several years even as the economy grew vigorously. For example, in a forecast made at the end of 1998, economists at the Organisation for Economic Co-operation & Development predicted that U.S. productivity growth would plunge to an abysmal 0.4% in 1999. Even the respected and nonpartisan Congres-



JULY 14, 1997

JAN. 3, 2001 Sensing economic weakness, the Fed starts slashing the federal funds rate from its 6.5% high.

MARCH, 2001 The longest-ever expansion ends as the economy falls into Greenspan's second recession. It lasts until November.

DECEMBER 16, 2002

JAN. 31, 2006 Greenspan plans to leave office

JUNE 30, 2004 With the economy growing again, the Fed begins tightening once more.

997 1998 1999 2000 2001 2002 2003 2004 2005 2006

MAY 20, 1997 Greenspan wins a fight inside the Fed against raising rates, trusting the New Economy.

EC. 5, 1996 Greenspan sks whether the stock arket's rise reflects rational exuberance."

SEPT. 28, 1998 The Fed orchestrates a private rescue of hedge fund Long-Term Capital Management. The next day it begins cutting rates to stave off a global liquidity crisis.

MAR. 10, 2000 The NASDAQ Composite Index peaks at over 5,000. It falls more than 75% in the following 2½ years.

APRIL 2, 2001

JUNE 25, 2003 Amid complaints of a "jobless recovery," the Fed reduces the funds rate to a 45-year low of 1%.

JULY 5, 2004

APPLAUSE FROM A TOUGH CROWD

"It's clear that Greenspan has been the most effective chairman of the Fed since its inception."

MILTON FRIEDMAN
Nobel laureate, Hoover Institution

"Like most people who've had a lot of luck, he has probably created a lot of it by his own smartness. The flip side of it is, he's become increasingly seat-of-the-pants."

JIM O'NEILL
Head of global economic research, Goldman Sachs in London

"You know, o two mistak in 19 years isn't b for the chairman the Fed."

CHUCK GRA
Senator (
Finance Committee ch

"He's the best Federal Reserve chairman in history. I think he will go down as perhaps the best central banker of all time."

RICHARD M. KOVACEVICH
CEO, Wells Fargo

"One of the key mysteries for me—and I have a huge admiration for his work overall—was Greenspan's decision in 2000 and 2001 to support the tax cuts."

LAURA D'ANDREA TYSON
Dean, London Business School, Clinton Administration economic adviser

"The key is t have good sensing mechanis about when to tu on and turn off th spigot. Greenspan had a remarkable sense of that."

FRED HA
CEO, Schering-

sional Budget Office did not start raising its long-term productivity forecasts until 1999.

Given how long it took most economists to grasp the reality of the New Economy, it's worth asking if the boom would have happened if someone other than Greenspan had been in charge of the Fed during the critical 1990s. Counterfactual history is always speculative, but it's possible that a more cautious Fed chairman would have raised rates in 1997 and 1998, as most economists advocated, and choked off the boom of the 1990s before it went into full gear.

COOL HEAD

IN A WORLD without Greenspan, much of the beneficial technology investment of the late 1990s might never have occurred, and even worthy startups might have had a harder time getting funding in a tighter credit environment. Unemployment almost certainly would not have been allowed to fall to below 4%, as it did in 2000, and real wages would probably not have risen for the broad mass of American workers—something that hadn't happened since the early 1970s.

It may also turn out that Greenspan's willingness to run the economy "hot," and tolerate the resulting booms and busts, is the best way a central bank can foster innovation is taking startups thrive in the hothouse atmosphere of a like the 1990s, when capital is relatively cheap. Then the st though painful to investors, knock out the losers, like thi in a garden to let the most robust plants grow.

On a visceral level, such a boom-and-bust approach a al most economists, who have been trained since graduate s o to prefer steady growth. Indeed, one of the biggest virtues t inflation-targeting approa f vored by new Fed chief B Bernanke is that it is supp s to reduce the volatilit growth, inflation, and the fa cial markets.

But such volatility may a inevitable feature of an ec my where growth is drive unpredictable technolo c advances. Greenspan cert n understood this new v better than most econo He showed how monetar icy can work with and technological change r than fight it—and that m his real legacy. ■

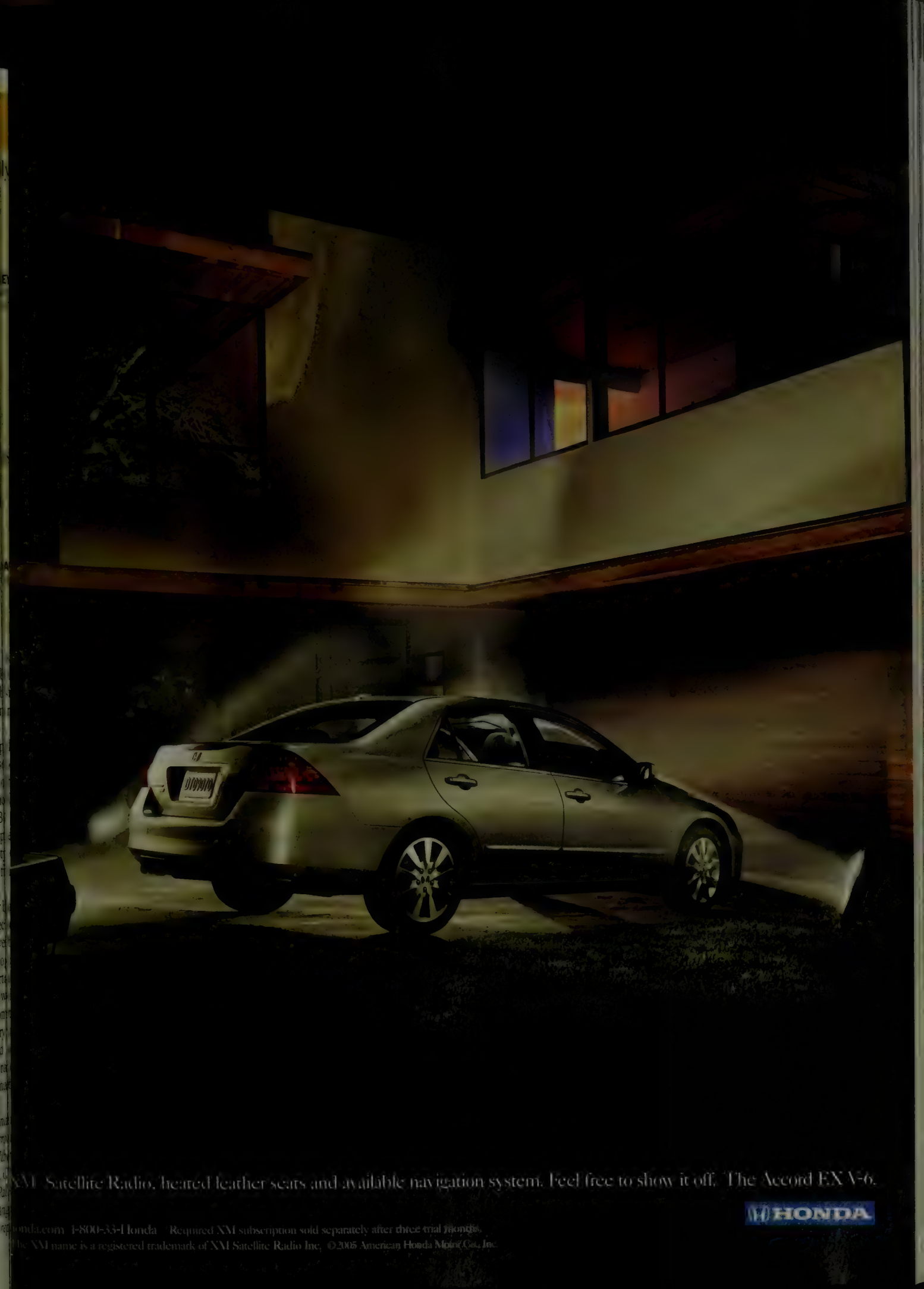
–By Michael Man
New York, with Peter Elstr
New York, Justin Hi
in San Mateo, C
Christopher Pa
in Los An
and bureau re

WHAT HE LEAVES BEHIND

Today's economy is healthier than the one Greenspan inherited 18 years ago

	1987	2005
Core Inflation*	3.9%	2.0%
Unemployment rate	6.0%	5.1%
Productivity growth**	2.3%	3.1%
Federal funds rate	6.75%	3.75%
Real stock market***	100	212
Real wages****	100	106
Debt as percent of GDP*****	183%	204%

* Changes in consumer prices over previous year, omitting food and energy
** Five-year growth rate of nonfarm productivity
*** S&P 500 index adjusted for inflation. August, 1987 equals 100
**** Third quarter of 1987 equals 100
***** Debt of government, households, and nonfinancial business
Data: Bloomberg Financial Markets, Bureau of Labor Statistics, Federal Reserve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AIRCRAFT

BOEING ROARS AHEAD

It looks poised to outdistance Airbus on orders for jetliners

AS PLANE DEALS GO, this could well be the biggest prize in recent memory. In December three major Asia-Pacific carriers are expected to place orders for more than 100 widebody jets worth an estimated $16.8 billion. And by the looks of things, Boeing Co. looks poised to supply most of the planes.

The Chicago-based aerospace company has been on a roll lately, racking up orders at a phenomenal pace for its 787 Dreamliner—and the new jet could account for half of the Asia-Pacific orders. But Boeing also is getting some unexpected lift from another plane: the 777. Thanks to the rise of its two most fuel-efficient widebody jets at a time of rising energy prices, Boeing has a potent one-two punch that could knock European rival Airbus into second place for years to come. Says Randy Baseler, Boeing vice-president for marketing: "We feel very confident about our strategy."

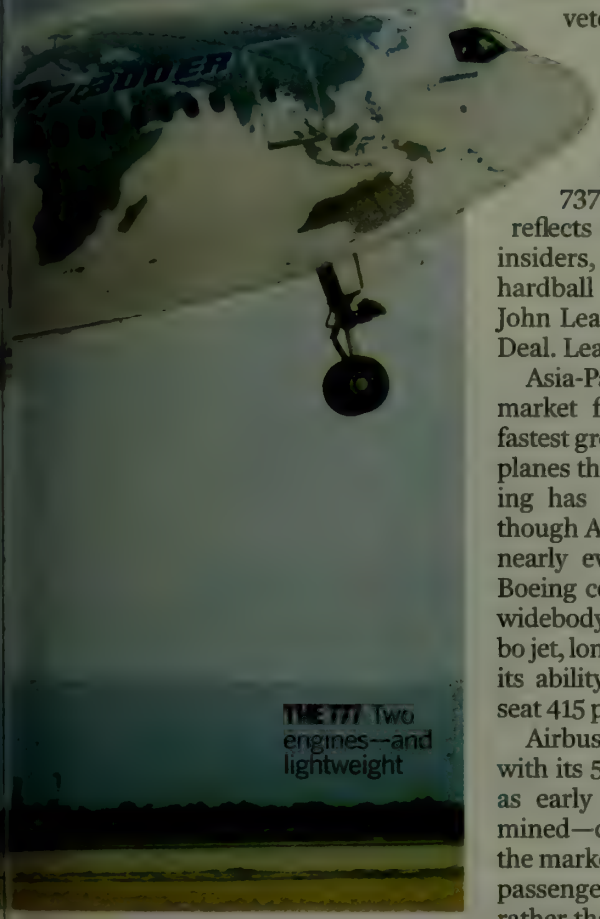
Of course, in the bare-knuckles aviation game, a Boeing triumph is hardly assured. Airbus, famous for aggressive sales tactics, could swoop in at the last minute and undercut Boeing on price. Airbus declined to comment for this story.

But if Boeing wins all or even most of the Asia-Pacific orders, as many insiders expect, this could provide a major boost to the commercial side of its business, even as defense goes into a trough. While Boeing's third-quarter revenues and earnings suffered because of a four-week strike earlier this year at its commercial airplane unit, the company raised its earnings outlook for this year and next, citing stronger demand for commercial airplanes. A big win in the Asia-Pacific region could add to Boeing's backlog of $98 billion worth of new planes and boost operating profits by $3.5 billion over the next five to seven years. Even better, a victory would further validate Boeing's twin-engine, point-to-point strategy—based around the idea that carriers prefer to fly smaller, more fuel-efficient planes non-stop between two far-flung destinations.

Boeing's resurgence comes at a time when Airbus is stalling badly. Delivery delays of its 555-seat A380 super-jumbo have angered key customers. And a lack of ability to settle on the final design for its new A350 has given the 787 and 777 an even bigger head start. More trouble yet for Airbus: Its four-engine A340 is deemed a gas guzzler. "Boeing sees Airbus as weak, and they're right," says Doug McVitie, an aerospace consultant who used to work for the European plane maker. "Airbus has had a terrible year."

BIG-GUN SALESMEN

AIRBUS' STUMBLES are helping Boeing win over the three carriers: Singapore Airlines, Qantas Airways, and Cathay Pacific Airways. While Singapore and Qantas won't say which jets they intend to buy, industry insiders believe both are leaning toward Boeing. The two carriers are said to be upset by the delays besetting the A380 and want to cut fuel costs



THE 777 Two engines—and lightweight

Cathay Pacific is a closer call, insiders say, and more attuned to price. All three are in the market for 777s or A340s: Singapore and Qantas are considering the 787 vs. the Airbus A350, and Singapore also is interested in the 747 advance, which Boeing says could be launched in December. Says one industry insider: "Singapore looks good. I'd bet on Qantas. Cathay is more quixotic."

Boeing is taking no chances. It has dispatched legendary salesman Larry Dickenson, a senior vice-president for Asia-Pacific sales, to lead the charge. A veteran of the Asian airplane wars, Dickenson is largely responsible for persuading Japan Airlines Corp. and All Nippon Airways Co. to build their fleets around the 787, 777, and 737 airplanes. Tapping Dickenson reflects a more aggressive Boeing, say insiders, and one that is willing to play hardball with Airbus super salesman John Leahy—long the master of the Big Deal. Leahy declined to comment.

Asia-Pacific has always been the key market for both jetmakers. It has the fastest growth, and it buys the biggest airplanes that generate the most profit. Boeing has hung on to Asia-Pacific even though Airbus eroded its market share in nearly every other region. Even today, Boeing controls nearly 60% of the Asian widebody market—thanks to its 747 Jumbo jet, long favored by regional carriers for its ability to fly immense distances and seat 415 people, and rising sales of the 777.

Airbus had aimed to supplant the 747 with its 555-seat A380 mega carrier. But as early as 1999, Boeing execs determined—correctly as it turned out—that the market was changing. They predicted passengers would prefer to fly nonstop rather than fly through a hub and switch from a big jet to a smaller one. Filling that demand, Boeing figured, would require fleets of smaller, twin-engine planes rather than Airbus' four-engine A340.

At first, some Asian carriers were hesitant about flying immense distances over oceans on two engines. The fear was that if one engine quit, they wouldn't have enough range to make an emergency landing. But during the 1990s, the 777 proved that it could fly long distances with few engine problems. And before long, Asia-Pacific carriers began buying larger versions of the plane that seated more people and flew farther. "Operationally, the 777 is a brilliant machine," says Tim Clark, president of Emirates Airlines, which operates Boeing and Airbus aircraft. "She flies fast. She flies high. She has extremely good economics."

THRIFTY ON FUEL

INDEED, BOEING'S MOVE to twin-engine planes couldn't have come at a better time. Rising fuel prices have prompted carriers to seek out more efficient jets—and two engines are a whole lot cheaper to operate than four. The 777 burns about 24% less fuel per seat-mile than Airbus' four-engine A340. That's a huge difference, and some airlines flying A340s—such as Air Canada, Austrian Airlines, Singapore and possibly Qatar—are looking to replace them with 777s. It's easy to see why there's a backlog of 189 orders for the 777 vs. only 79 for the A340. "You don't need four engines anymore," says Edmund S. Greenslet, editor of *The Airline Monitor*. "The A340 is going the way of the dinosaur."

Boeing flew its two-engine strategy into the stratosphere when it launched the lightweight, carbon-fiber-based 787 Dreamliner. This new twin-engine jetliner, which will seat between 214 to 250 passengers, will be able to fly nonstop from Los Angeles to Sydney and burn 20% less fuel than existing similar-size twin-engine jetliners. The Dreamliner, so far, has chalked up 293 firm orders and commitments from 24 customers, compared with 143 orders and commitments for Airbus' new, lighter A350.

Airbus isn't out of the game by any means. While the A380 may not be a financial success in the near term, it will probably follow the same history as Boeing's 747 and score big in another decade. "It's too early to judge the success of the A380," says Greenslet. "What's clear is that it's not going to be a profit center for them until 2020, but that doesn't mean there won't be a demand for a big airplane eventually." What's more pressing for Airbus now is defending the markets for medium and large passenger jets. Much will depend on which way Singapore, Qantas, and Cathay decide to fly. This one is definitely Boeing's to lose. ■

–By Stanley Holmes in Seattle, with Carol Matlack in Paris

High Stakes

Boeing may blunt Airbus' lead by sweeping three big orders. Potential sales numbers:

	SINGAPORE	QUANTAS	CATHAY	VALUE (BN)
777-200LR	5	20	0	$4.3
777-300LR	0	10	15	4.7
787	20	30	0	5.3
747 advance	15	0	0	2.5
TOTAL	40	60	15	16.8

Data: BusinessWeek

(787) AFP/GETTY IMAGES

CHINA

DELL MAY HAVE TO REBOOT IN CHINA

Direct sales aren't a hit in the hinterlands, where folks want to see before they buy

YOU COULDN'T BLAME Michael S. Dell for sounding a little bit smug about his company's prospects in China during a cocktail party for analysts in Austin, Tex., last April. Dell Inc.'s market share in Asia was growing fast, and it looked as if its formula of selling PCs directly to customers over the Internet and phone was catching on just as it had in the U.S. "Demand for our products and services in China is tremendous," he said, adding that "99% of the economic value in China is in the large metro areas" where Dell was concentrating its efforts.

All of a sudden, Dell's strategy in Asia is looking a little shaky. Third-quarter numbers released by tech market researcher IDC show Dell's market share for Asia, excluding mature Japan, dropped by a full point, to 7.8%. Then, on Oct. 25, the company announced that the co-president of its Chinese operations, Foo Piau Phang, had "chosen to retire."

What's happening to Dell's march on Asia? The company won't talk—it's in the quiet period before its Nov. 10 third-quarter earnings announcement. But there's plenty of evidence suggesting it is out of sync with shifting market conditions in fast-growing China. While Dell has focused on large business and government customers in the country's major cities, demand is emerging elsewhere—in hundreds of smaller cities, where Dell doesn't sell as effectively as its rivals and where even some business customers want to see products before they buy. That's where competitors Lenovo, Hewlett-Packard, and Founder have been selling briskly through retail shops. Says HP Executive Vice-President Ann Livermore: "You have to wonder, how well does the direct model work in the hinterland?" HP has invested heavily in hiring staffers and recruiting retailers in secondary Chinese and Indian cities.

CHANGCHUN A Dell promotional poster

The China setback is just the latest in a string of recent disappointments for Dell. Since the Round Rock (Tex.) company missed its second-quarter revenue target, its stock price, which peaked at $42 a share in July, has sunk to less than $32. A survey by the University of Michigan recently showed a decline in Dell's customer-satisfaction rating. Also, the company was embarrassed in China in May after the publication of an e-mail from a Dell salesman criticizing the Chinese government—a key Dell customer.

FEW CREDIT CARDS

A SHARE DECLINE for one quarter does not make a trend, of course. Dell sees China in particular as a key growth market, where it already has 5,000 employees. It is even in the process of building a second factory in the southeastern coastal city of Xiamen. Over the long haul, Dell may have the most successful model for Asia just as it does in the U.S., since today's first-time PC buyers could well evolve into tomorrow's online shoppers.

Yet at least in the near term, the company may have to attack. Dell isn't pursuing consumers, an area that is growing far faster than the business sector. If Dell does start chasing consumers, Dell's direct-sales strategy might falter because relatively few Chinese customers use credit cards, and those who do aren't accustomed to buying over the phone or the Internet. "The reality is Dell needs to establish more of a presence on the street," either through sales kiosks or retailers, says Roger L. Kay, president of consulting firm Endpoint Technologies Associates Inc. in Waltham, Mass.

While Dell dominates in the U.S. and other developed markets, it is outgunned at the moment in Asia. Lenovo, the leader with a 20.4% market share, has more than 4,800 retail outlets in China alone. Innovations such as its Jiayue consumer desktop designed specifically for families, featuring pre-installed education software, have helped it gain share in smaller cities. This local champion is not likely to crumble under Dell's onslaught.

Even so, Dell is loath to break with its direct-sales strategy. Previous forays into retail distribution, both in the U.S. and in China, ended quickly. Yet if the company hopes to dominate in Asia, it may be forced to play outside of its comfort zone—at least for a while. ■

–By Louise Lee in San Mateo, with Peter Burrows in San Mateo and Bruce Einhorn in Hong Kong

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COMMENTARY

BY DAVID WELCH

What My Dad Taught Me About GM and the Auto Workers

Fat wages and benefits can't last when competition is cutthroat

AS A LONGTIME observer of the auto industry, I've been watching the unfolding drama between General Motors Corp. and the United Auto Workers with mixed emotions. On the one hand, without serious union concessions, including the recent giveback on health care, GM will never gain an edge on low-cost foreign competition. Its slide toward bankruptcy will continue. At the same time, I know from personal experience that a weakened UAW—truly one of the last unions that can guarantee blue-collar workers a comfortable living—isn't good for America's middle class.

But the fact remains: A union auto worker still has it better than any other factory hand in the country. And while GM is hugely responsible for the fix it's in—relying too long on gas guzzlers for most of its profits is just one in a long list of missteps—I'm not convinced that the UAW rank and file fully accept that the world has changed. Yes, their vaunted lifestyle—vacation cottages in Michigan lake country, enough money to send the kids to college, living without fear of unpaid layoffs—isn't going to disappear tomorrow. But major concessions are coming.

THE HARSH LIGHT OF DAY GM can't keep paying salaries to furloughed workers

UAW workers have managed to freeze the clock much longer than most of their blue-collar brothers and sisters. My father saw the writing on the wall as far back as the late '70s, when union power started to fade. In 1979 he made $16 an hour—the equivalent of $44 an hour today—as a union machinist at Miller Brewing Co.'s brewery in Fulton, N.Y. The union's 1,500 workers went on strike that year over cost-of-living increases. My dad walked the picket line dutifully but thought the union was being too stubborn. After all, the nation was in recession, and many other Americans were losing their jobs.

The two sides settled the strike, but the world was about to change. Much like GM is suffering today, Miller was in [illegible] through the '80s as domestic beer sales dropped. By the e[illegible] the decade it would get hit by hipper rivals—in this case b[illegible]ers such as Heineken and Corona—as well as Budweiser, w[illegible] was marketing the heck out of its brews. With sales going [illegible] Miller laid off 100 or so workers, my father among them, [illegible] the possibility they'd be recalled if things picked up. Miller [illegible]er did call, and by 1994 the Fulton brewery was closed.

UAW workers aren't there yet, but the clock is ticking. [illegible] becoming increasingly difficult to justify their outsize w[illegible] and benefits. Yes, the UAW will forgo most pay raises fo[illegible] next two years, but their $25 an hour is still 50% better [illegible] what the average plant worker now makes. UAW workers [illegible] get free health care. They also have pensions; half of m[illegible]facturing workers and most employees don't. Perhaps mos[illegible]tounding, the $752 annual premium that their retirees wil[illegible] for family medical coverage is just one-fourth the contribu[illegible] that the average working family pays in the U.S.

In short, the time has com[illegible] serious concessions. The idea [illegible] UAW workers can't be laid [illegible] without pay is an artifact of a[illegible] gone era. GM has suggested th[illegible] may cut 25,000 workers by 2[illegible] but mostly through retiren[illegible] Let's face it: If GM can't sto[illegible] market-share slide, the auto n[illegible]er is going to need many m[illegible] cuts than that, and it won't be [illegible] position to pay furloughed w[illegible]ers up to 90% of their salaries [illegible] it does today.

Dirt-cheap health care won[illegible] around much longer, either. [illegible] getting retirees to pay som[illegible] their costs under the recent [illegible] GM can wring out $1 billion a [illegible] in savings. But factor in hea[illegible] care inflation, and GM's outlays will be close to today's level [illegible] the time the current labor contract comes up for renegotia[illegible] in 2007. The upshot: Union workers will likely have to [illegible] paying for some of their health care, and it will have to be m[illegible] than the relatively small contribution that retirees will soon [illegible]

All of this will be painful—just as it was in the early 1980[illegible] my family and countless other middle-class families. The U[illegible] should be glad they've had it this good for so long. ■

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TOYS

DEAR SANTA: SKIP THE BATTERIES

Sales of non-electronic board games, puzzles, and building sets are climbing

AUTOMOBLOX
Automobox
$32

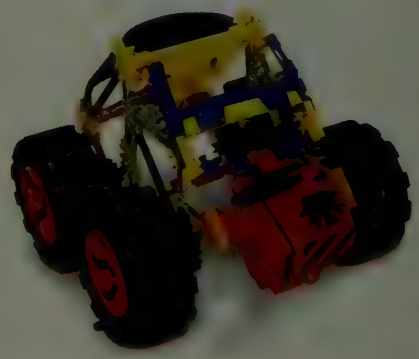
SCAN ANY LIST OF THE toys expected to fly off store shelves this holiday season, and you'll see a slew of electronic playthings and kid-size gadgets from video cameras to handhelds that teach math. The widely followed Hot Dozen list from *Toy Wishes* magazine, for one, includes only three items that don't have a computer chip. Last year, sales of tech-based toys grew an estimated 19%, siphoning off sales from such traditional playthings as stuffed animals, dolls, and art supplies.

BUMPARENA
Cranium Inc.
$16

But with parents increasingly agitated by the amount of time kids spend with video games and other mind-numbing chip-based toys, companies large and small are finding there's money to be made selling old-fashioned stuff—from puzzles to board games to building sets. Even as sales in the $20 billion industry fell 3% last year, according to researcher NPD Funworld, sales of family-oriented board games jumped 12%, puzzle sales rose 26%, and games for preschoolers climbed 27%. Not only are pediatricians advising parents to limit "screen time" to two hours a day but also, says independent industry analyst Chris Byrne, parents increasingly are seeking toys that will help make their kids "physically and socially adept."

Some board game makers are pushing the notion that their products encourage verbal interaction between kids—and maybe even between parent and child. "The countertrend to all the technology toys is the human yearning for a sense of togetherness," says Richard Tait, chief executive of privately held Cranium Inc. His Seattle outfit this year has unveiled three new products, including Bumparena, a $16 game in which players place pinball machine-style bumpers on a slanted board, release small balls at the top of the board, and try to guide them into a goal at the bottom. Pretty basic, right? Well, according to Tait, Cranium's sales of such family-oriented games grew 320% over the past two years.

Another angle: selling toys that purportedly help boost kids' spatial skills. Automoblox Co., for example, is in its second year of selling a line of $32 wood-and-plastic cars that kids as young as four years old can take apart and mix and match to design their own models. Last year, the toy company startup, based in Roseland, N.J., sold all 12,000 cars it had in stock, says President Patrick Calello. This year, Automoblox has already shipped more than half of its 60,00- c output to retailers. What's the appe? I dependent toy analyst Stephanie C e heim says that the toy cars are a h w i kids because they're "part vehicl pa puzzle." And hey, parents: no batte s r quired and no beeps or sirens. "It's nic quiet toy," says Calello.



FLEX K'NEX CONSTRUCTION SQUAD
K'NEX Industries
$29.99

Even building sets are maka comeback. RoseArt Industries I.. unit of Montreal-based Mega Blok In this fall unveiled Magnetix M g World, construction kits whose m ne ic pieces let children build skyscr e action figures a vehicles. And N Industries Inc.' ne Flex K'NEX prod have flexible - a that can be us assemble cars a spaceships. n building sets le k as young as fiv o struct relatively o plex structures s and quickly, toy n lysts say. Indiv pieces in the M g World kits, for e ple, incorporate a nets that help t hands connect a t parts firmly. To get the word out, Ro A is displaying 18-inch-high clock to made of the magnetic parts in toy st

MAGNA TOWN SQUARE
Magnetix
$29.99

Plenty of tech-free toys are du course. Sales in the U.S. of Mattel c Barbie dolls, for example, dropped 3 the most recent quarter. Indeed, i mand for traditional toys is goi bounce back, says NPD Funworld to alyst Anita Frazier, "there'll have more creativity" on the part of man turers. That's especially true in the Apple Computer's iPod, which, again, is expected to top countless holiday season wish lists. ■

-By Louise Lee in San Mateo,

Beyond Gadgets

Some surprising bright spots in Toyland don't need a computer chip

2004 SALES GROWTH

PRESCHOOL GAMES	PUZZLES	FAMILY BOARD GAMES	INDUSTRY
27%	26%	12%	–3%

Data: NPD

BE HERE FASTER

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EDITED BY MONICA GAGNIER

HEADLINER

JIM BALSILLIE

BLACKBERRY: A BLACK DAY

The stakes for Jim Balsillie, chairman of Blackberry maker Research In Motion, couldn't get much higher. Already under siege from rivals in the e-mail device market that RIM pioneered, Balsillie suffered a major setback on Oct. 26 when the U.S. Supreme Court refused his request to freeze proceedings in a patent fight.

That brings the potential shutdown of BlackBerry e-mail service and the halt of sales in the U.S. a step closer. RIM requested the emergency stay pending review by the high court of its four-year-old dispute with NTP, a private holding company.

Wasting no time, NTP's lawyers plan to file for a reconfirmation of an earlier order to shut down BlackBerry. That could take weeks, though, since a lower court has to schedule hearings on that filing and on RIM's request that the court enforce a $450 million settlement that fell apart in June. Still, the heat is on for Balsillie to reach the last-minute settlement that analysts are expecting.

–Heather Green

THIS MAY HURT A LITTLE

Washington is widening its investigation into makers of big-ticket medical devices. The three top producers of defibrillators and other implantable cardiac devices—**Medtronic, Guidant,** and **St. Jude Medical**—have been subpoenaed by the Justice Dept. The demand for records comes seven months after U.S. Attorneys subpoenaed five makers of artificial joints. The probes focus on payments these manufacturers make to surgeons for consulting work. The aim is to see whether the fees are for legitimate work or are a way of awarding doctors for using company products. Prices of heart devices can easily top $10,000, and surgeons typically have discretion over which brand they implant.

CBS NEWS LOOKS WITHIN

After months of speculation about who might succeed Andrew Heyward as head of **CBS News,** the network has decided to stay in-house. On Oct. 26, the network announced that Sean McManus, 50, president of CBS Sports, would oversee news as well. As a result, McManus becomes only the second network sports boss in history to run a news division, too. The legendary Roone Arledge did so at **ABC,** where McManus' father, sports commentator Jim McKay, worked for years.

BIG BANKS MUST PAY UP

A group of institutional investors has won a $651 million settlement against several banks that issued **WorldCom** bonds. The group, which includes the **California Public Employees' Retirement System** and worker retirement funds in several other states, had opted out of a $6.1 billion class action settlement last month between WorldCom investors and several investment banks. As part of the deal, defendant banks in the case, including **Citigroup** and **JPMorgan,** will join with investors to ask the **Securities & Exchange Commission** to tighten rules on securities offerings to include disclosure of commercial bank loans made to issuers and issuers' officers and directors.

CABLEVISION BACKS OFF

Just four months after they decided to take **Cablevision** private, the father and son who run the company have changed their minds. The flip-flop will surely prompt frustrated investors to pressure the Dolans, who control 20% of the company, to sell the nation's sixth-largest cable operator. In a letter to Cablevision's board on Oct. 25, Chairman Charles Dolan, 79, and CEO James, 50, wrote that they were abandoning plans to privatize the cable systems and spin off the rest of the company to shareholders because they couldn't agree on the value of the properties with a commit[illegible] of the board. Instead, the[illegible] proposed a special shareholder dividend of $[illegible] billion. Cablevision share[illegible] declined 13%, to about $2[illegible] on the news. **Time Warner** [illegible] a likely bidder, but it's not clear whether it wants su[illegible] noncable units as Madiso[illegible] Square Garden.

ET CETERA...

- **Bausch & Lomb** is probi[illegible] allegations of improper accounting at its Brazilian unit.
- **U.S. Steel's** third-quart[illegible] profits plunged 70%.
- The **SEC** has upgraded [illegible] probe of **GM's** pension accounting to a formal investigation.

CLOSING BELL

So much for Harry Potter's magic. Despite selling 1.6 million copies of *Harry Potter and th[illegible] Half-Blood Prince,* Amazon.com saw its third-quarter profit fall 44%, due to a legal settlemer[illegible] and rising costs. After analysts cut their price targets, the stock dropped 14.2%, to $39.64.

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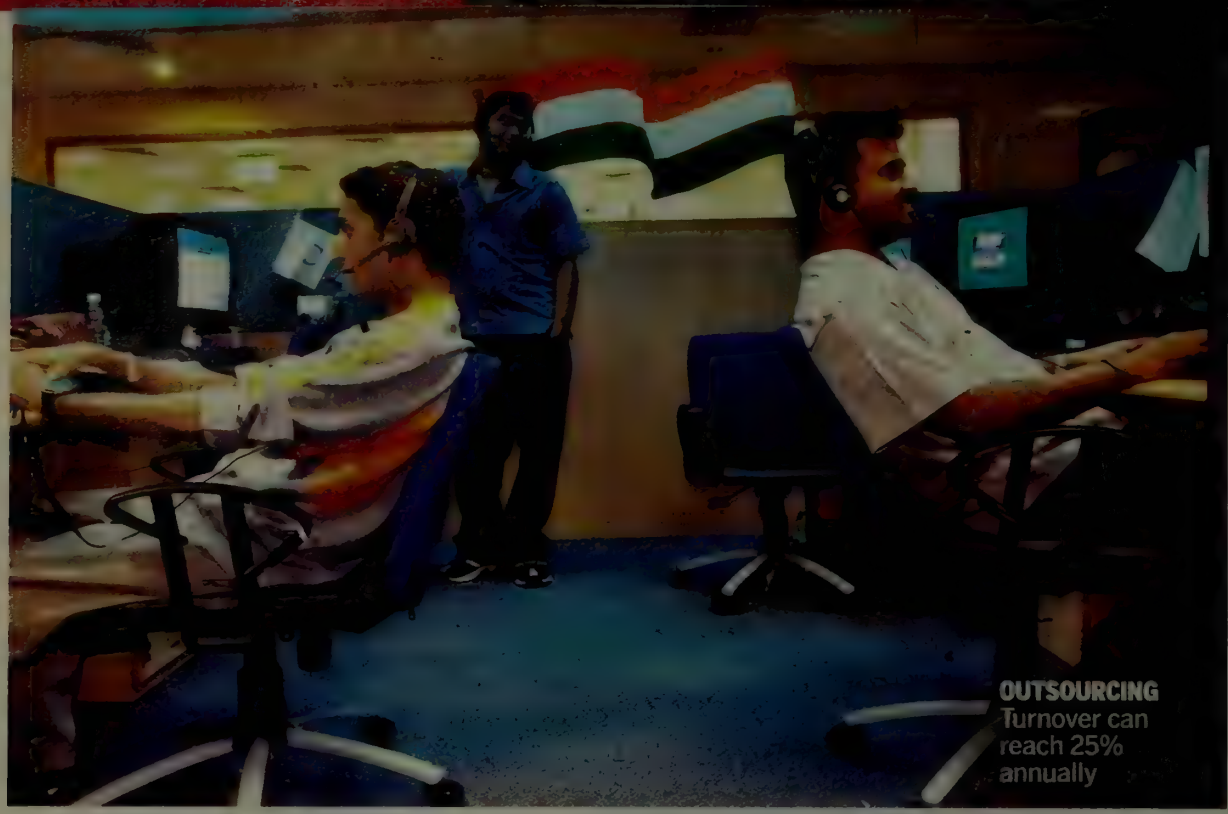


OUTSOURCING Turnover can reach 25% annually

LABOR

INDIA'S SKILLS CRUNCH

As the economy booms, companies scramble to find trained workers

INDIA'S ECONOMY IS ON A TEAR, so these should be heady times for Bombay-based Larsen & Toubro Ltd. The company, India's largest construction and engineering outfit, has seen its sales jump by 35% in the past year as Delhi builds more roads and ports and India Inc. invests in factories and office parks. But L&T Chairman Anil Manibhai Naik can't hire enough mechanical engineers to keep up. Despite boosting wages for rookie engineers by 25%—to roughly $5,700 per year—Naik is still losing potential recruits to software houses, multinationals in India, or Persian Gulf rivals. Says Naik: "Everyone is growing fast, and India is facing a talent shortage."

A shortage of talent in India? That's right. Companies worldwide are rushing to tap the coutry cheap and abundt l bor force. But ne I dia's domestic grth taking off, creati u precedented demad f good workers. "T e gines of the servic a manufacturing sto are going simultan us and that's creati t shortages," says Sir Sankhe, a partner wi consultancy McKinsey & Co. in Bob

Multinationals—from Pepsi to Ge Electric to Citibank and Accenture are part of the problem. As they pile in I dia, they have helped fuel an explosi wages, especially in the tech sect F years they have offered Indian t salaries, opportunities to work ab and prestigious credentials. "We ve strong positive image in India, an it very high-end, challenging work, sa John C. Wall, Chief Technical Offi Indiana-based Cummins Inc., wh expanding its 120-engineer researc ter in Pune. But as both domestic an fo eign companies push deeper into areas such as retail, industrial engi ing, and pharmaceuticals, the bidd heating up. Today, salaries for s managers at some Indian compa nearly equal those at multinational

NOT JUST TECH

INDIA'S TALENT SHORTAGES st appearing last year in technolog an outsourcing; attrition rates in those us nesses today top 25% annually. P f qualified managers in tech has shot p much as 30%, and now everyone i cluding top foreign companie

Seeking Talent
Where India lacks skilled workers

TECH
A shortfall of project managers has boosted salaries by 30%, to some $23,000 a year, while poaching is rampant.

MANUFACTURING
Many engineers have defected to the software sector, so there aren't enough to support factories and mills.

RETAIL
Faces a severe shortage of both managers and sales clerks as 2.5 million new jobs will likely be added by 2010.

AVIATION
The country today is 1 pilots short and will n 3,200 more by 2010.

Data: Nasscom; L&T; Gama Brand agement; Center for Asia Pacific Av

rambling. Even Genpact, India's rgest outsourcing shop and 40% owned GE, has had to innovate. It has set up all storefronts in six cities to recruit orkers for entry-level outsourcing jobs. e skill shortage "is the biggest chalnge for our industry," says Pramod asin, chief executive of Genpact. Genct has hired 650 new staffers from the nters, but turnover is still 30% a year.

As India's domestic economy expands, e shortfalls are spreading. Wages for mi-skilled workers in the textile factoes of Coimbatore are up 10% this year, hile supervisors' salaries have risen by %. Pay in the banking industry is up 5% in the past year and has more than oubled in hot areas such as private equi. Overall, Indian salaries will rise by .8%, compared with inflation of 5.5%, aman resources consultant Mercer says. Many companies are muddling rough by hiring less-qualified employs and training them. Private institurns are starting to offer courses for veryone from flight attendants to engibers. More private colleges are springing e, and some 450,000 new students are rolled in engineering schools this year, 80% from last year. "India has a huge lucated workforce," says Dominic Price, Morgan Chase & Co.'s chief in India. As it gets equipped with new skills, it ill temper the current wage inflation."

Yet the needs are vast. With more Indins able to afford cars, tractors, and reigerators, the country's factories are exected to need 73 million workers by 015, 50% more than today, according to cKinsey. And as India's traditional vilge kiosks and mom-and-pop shops are pplanted by hypermarkets and malls, e retail sector will add 2.5 million jobs 2010, human resources advisor Ma Foi anagement Consultants Ltd. estimates.

The shortfalls have led to an epidemic poaching. Established airlines have lost me 200 pilots to new discount carriers the past year. In retail, the demand for orkers is so intense that rookie sales erks sometimes don't show up on the st day of work: They get better opporities between the time they interewed and the job-start date. "If you on't like a job, you can change it tomorw and get three others," says Gita isinghani, who trains recruits for comnies in retail and outsourcing.

That has many managers crafting untermeasures to find—and hang on —good workers. Power-equipment aker ABB Ltd. was having trouble locatg enough qualified engineers. So in July started giving students nationwide a simultaneous written test online, with the best candidates offered jobs instantly. That has helped the company double the number of engineers it has hired. "India [has] a vast and young talent pool," says Ravi Uppal, ABB's India chief. "The challenge is to develop and shape this talent."

Some say Delhi should take the lead by making school curricula more relevant to today's India. Unless the education system can fulfill the aspirations of India's youth, the current boom could turn into a disaster, warns Rama Bijapurkar, a Bombay marketing consultant who advocates expansion of what she calls India's "boutique scale" elite schools. The aspirations of India's employers—who need more and better-trained workers than ever—will remain unfulfilled as well. ■

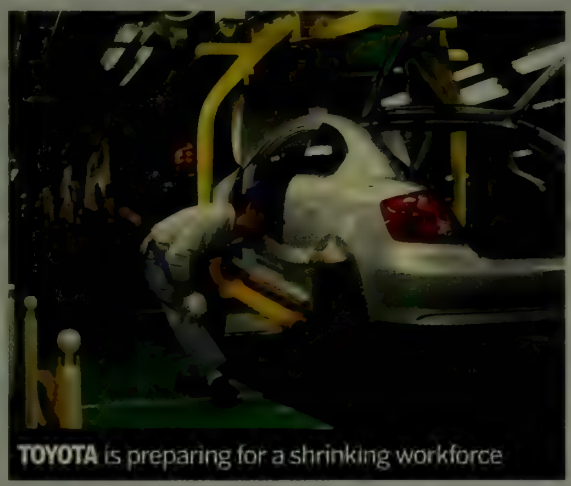
–By Manjeet Kripalani in Bombay

LABOR MARKETS

Japan: The Downside Of Downsizing

Japan spent the better part of the past decade in the throes of a recession. That meant companies took a machete to payrolls, often by forcing older workers into early retirement. Now Japan finds it doesn't have enough workers. Economic growth and corporate profits have come roaring back faster than most predicted. Job vacancies in high-end manufacturing and information-technology industries are getting tough to fill. The problem is aggravated by the fact that the Baby Boom generation is nearing the traditional retirement age of 60.

Companies are taking action. In the auto industry, retaining experienced engineers and skilled factory hands is now a priority. "To have these people retire all at once means that companies will not have enough time to transfer the knowhow to the younger generation," says Honda Motor Co. President Takeo Fukui. So he is hiring the best of his retirees as mentors for younger engineers.



TOYOTA is preparing for a shrinking workforce

Even mighty Toyota Motor Corp., which still has the best college grads lining up for jobs, is preparing for a shrinking workforce. It now offers one-year contracts to top employees who turn 60. Digital camera and copier king Canon Inc. may soon rely on robots to fill empty job slots. It hopes to have some assembly lines almost entirely automated by 2010.

With its hand forced by current shortages, Japan is also rethinking two other issues: ultratight immigration policies and underutilization of the female labor pool. On immigration, critics say Tokyo's priorities are skewed. Officials have spent months pondering whether to grant 100 visas a year to urgently needed Filipino nurses. At the same time 98,000 "entertainment" visas were handed out last year to Asian women, many of them sex workers.

The best bet for expanding the workforce is to open new opportunities for women, Japan's biggest untapped labor asset. Just 55% of all women work, vs. 62% in the U.S. Goldman, Sachs & Co. economist Kathy Matsui figures if Japan could raise the percentage to U.S. levels, it would add 2.4 million people to the labor pool. To ease the task, the government is expanding day-care facilities.

Without strong action from Tokyo, the situation will get worse. Due to its low birthrate, Japan's population will peak at 127 million in 2006 and decline to about 100 million by 2050. In the hunt for new workers, the nation's future prosperity is on the line.

–By Brian Bremner, with Hiroko Tashiro and Ian Rowley, in Tokyo

CONSUMER FINANCE

GE MONEY HEADS EAST

It's carving out a lucrative chunk of Asia's underserved credit markets

TUCKED AWAY in a post office in downtown Singapore is a booth manned by an employee of GE Money, the consumer finance arm of General Electric Co. Lunchtime customers wait in line to apply for personal loans. The GE unit began marketing uncollateralized loans, with 14% annualized rates, through SingPost just six months ago. And its booths offering cash on the spot have already carved out a lucrative niche. "We are delivering [financial] products to Singaporeans right where they need them," says Greg O'Callaghan, country head of GE Money, the new brand name of GE Consumer Finance in most markets outside of the U.S.

The booths are just one of the tactics GE Money is using to grab a piece of Asia's financial marketplace. Although the $15.7 billion GE unit is years behind rivals like Citigroup and HSBC in Asia, it's catching up fast.

After just two years in India, for example, GE Money became the No. 2 credit-card issuer. To start its China business, GE just bought a 7% stake in Shenzhen Development Bank. "We're trying to move our center of gravity to Asia," says David R. Nissen, president and CEO of GE Money.

Nissen says that as growth has slowed in mature markets such as Western Europe and Japan, emerging Asia has become increasingly attractive. In the first nine months of this year, consumer finance accounted for 12% of GE's $123 billion in sales and 13% of its $17 billion in profits. Asia is expected to make up less than one-quarter, or $698 million, of GE's total consumer finance earnings this year. But it is the fastest-growing segment, up 14% from last year's $610 million. Over the past 12 months GE has spent nearly $1.3 i[illegible] snapping up midsize finance firms [illegible] na, the Philippines, and South Kor[illegible].

The idea is to leverage wide[illegible] awareness of the GE name again[illegible] dle-class Asians' new desire to [illegible] everything from cars to groce[illegible] weekend flings on the installmen[illegible] Until now, that market has been [illegible] nated by a handful of players such [illegible] group's CitiFinancial—and less re[illegible] firms just a step up from loan shar[illegible].

IN SINGAPORE Cash in the post office

GE's Pacific Play

GE Consumer Finance is on a roll

AUSTRALIA
GE Money acquired five firms in auto financing, credit cards, and mortgage lending over the past six years to become a leading consumer finance player.

CHINA
Bought a 7% stake in midsize, privately run Shenzhen Development Bank for $100 million in October, 2005. Wants to issue credit cards through bank.

INDIA
Major credit-card player, with 50-50 partnership with State Bank of India. Has a growing unsecured credit, store credit, and auto-financing business.

JAPAN
Through a slew of credit-card and consumer finance acquisitions over the past 10 years, GE Money has emerged as one of largest consumer finance players.

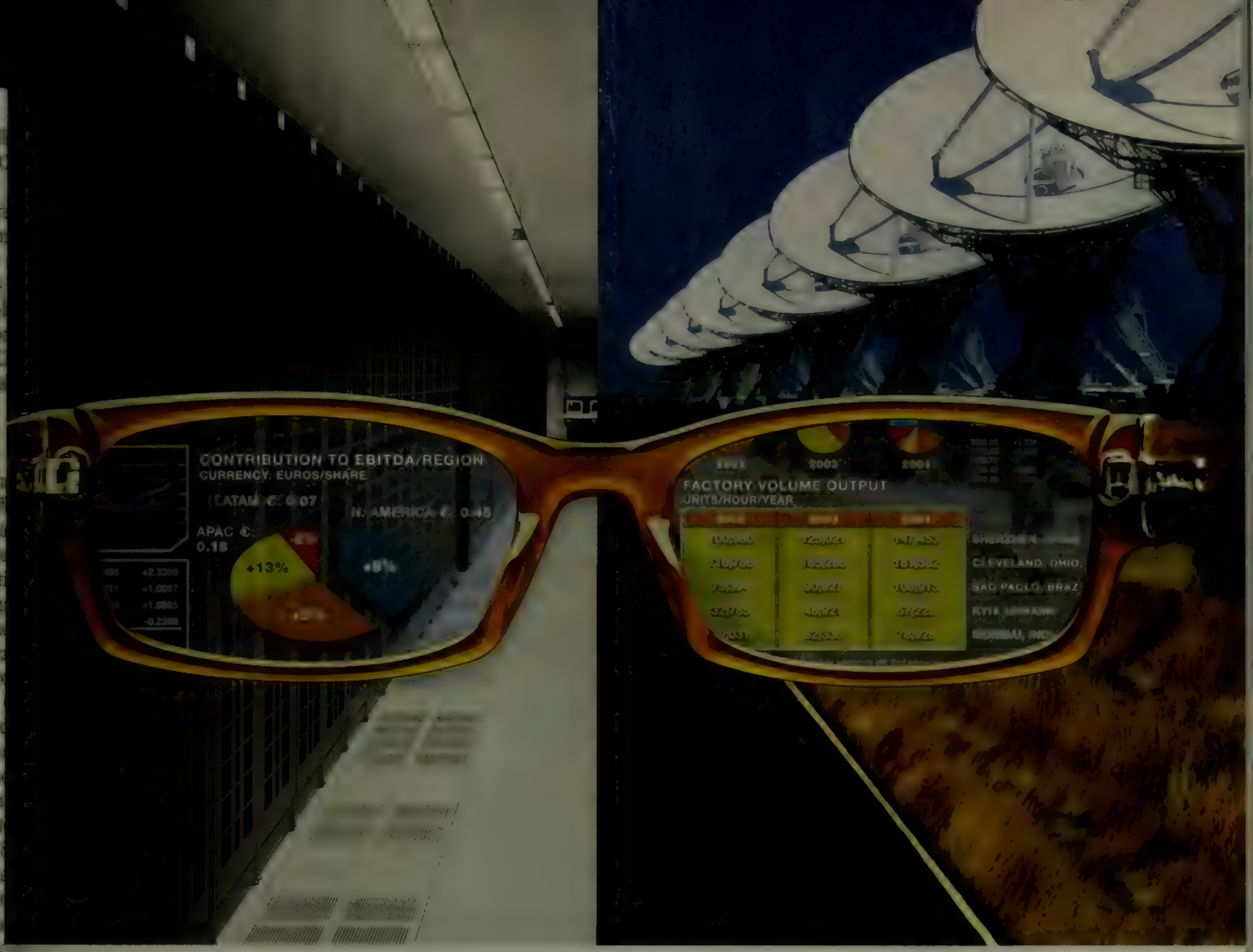
PAPER, NOT PLASTIC

ULTIMATELY, GE SEES itself becoming [illegible] financial supermarket in Asia that offe[illegible] services ranging from plain-vanilla ba[illegible] accounts to investment su[illegible] as insurance and secu[illegible]. But where GE has strugg[illegible] first is in credit card a[illegible] short-term unsecured ca[illegible] loans. A staple among co[illegible] sumers in Japan, whe[illegible] fine-tuned its business [illegible] such loans are finding a flo[illegible] ing elsewhere in Asia fo[illegible] who prefer borrowed c[illegible] plastic. One reason: Inte[illegible] on the loans runs betwe[illegible] and 15%, less than the ta[illegible] dard 16% to 22% on out[illegible] ing card balances. If fa[illegible] rates are kept below 4% wi[illegible] rigorous spot checks bas[illegible] computerized credit [illegible] "The biggest opportun[illegible] [Asian finance], we beli[illegible] in the consumer-finance us[illegible] ness," says Yoshiaki Fuj[illegible] president of GE Money A[illegible].

In its quest for m[illegible] share, GE doesn't hesit[illegible] seek out allies. In India [illegible] teamed up with the State [illegible] of India on a credit-car[illegible] gram. GE has won fans t[illegible] to a speedy application pr[illegible] using Six Sigma quality [illegible] niques that cut the wait [illegible] card from weeks down to [illegible].

To lay the groundwor[illegible] broader push, GE also [illegible] been bulking up. Its pur[illegible] of a piece of China's Sh[illegible] Bank provides a platform for credit [illegible] and other financial services. That deal [illegible] after the purchase of a Philippine sa[illegible] bank in September. The acquisitions [illegible] boast particularly high margins, b[illegible] doesn't care. "We don't buy growth," [illegible] Nissen. "We grow what we buy." ■

–By Assif Shameen in Bangko[illegible]
Diane Brady in New[illegible]



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EDITED BY ROSE BRADY

The Japan-China Oil Slick

WHEN CHINA AND JAPAN began negotiations months ago over billions of dollars' worth of oil and gas fields along their disputed sea border, it seemed a positive step for Asia's two biggest economies. On the agenda were plans to settle ownership of the fields and discuss joint energy development. But the talks stalled in early October. Instead, a new chapter in the increasingly ugly rivalry between Japan and China could start soon.

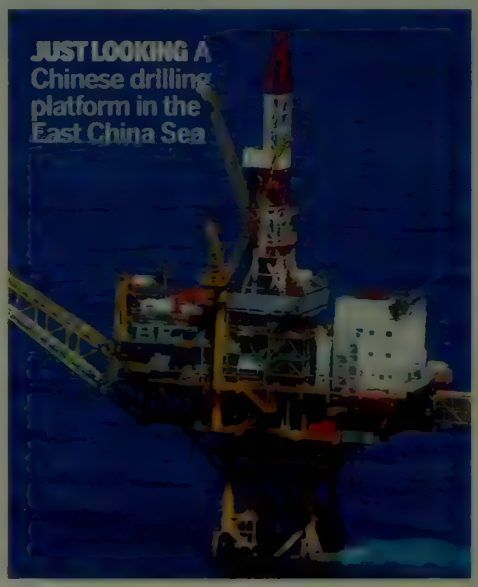
At the center of the dispute is the boundary between Japan and China, an imaginary line that runs through the narrow East China Sea. The two countries have haggled over the exact shape of the line dividing them for years. Four oil and gas fields were discovered and first mapped in the late 1980s. Japanese geologists think the fields may hold some 7 trillion cubic feet of natural gas and close to 100 billion barrels of oil. Today, in an energy-starved age, that's a huge prize, especially for Japan, which has no oil of its own, and for China, which has based much of its recent diplomacy on the quest for secure energy. According to Central Intelligence Agency stats, if the estimates are correct, the fields hold more oil than either Japan or China would consume in 50 years, and more gas than Japan could use in 80 years and China in 240.

Line in the Water

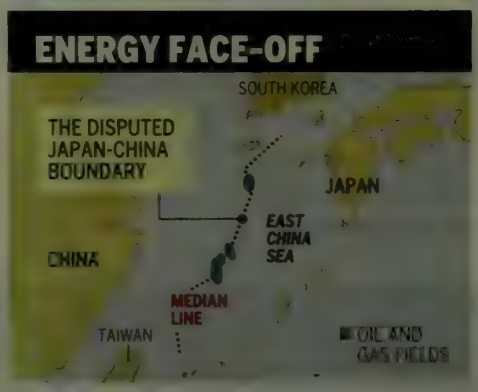
WITH SO MUCH AT STAKE, negotiations had deadlocked over the two sides' differing views of where to draw the boundary and which country should own the energy reserves. Then, as both nations prepared to resume discussions in Beijing in late October, the Chinese backed out. The apparent reason was Prime Minister Junichiro Koizumi's visit to Tokyo's Yasukuni Shrine, which honors 2.5 million Japanese war dead—including soldiers who had committed atrocities in China.

Koizumi's action was obviously provocative, and a backlash was to be expected. But the Chinese also want to show they can play tough when it comes to the vital question of who will control the oil and gas fields. Already, there's evidence that China is test-drilling on its own at the field known as Chunxiao in Chinese and Shirakaba in Japanese. China has said it has begun exploration, and has made clear that it will never accept Japan's proposal to draw a median line between the coasts of Japan and China. The Chinese platform is technically on its own side, to the west of where that line would lie. But Japan says it fears gas reserves on its side will be tapped by China's drilling since surveys show the deposits might straddle the line.

Now the Japanese want to riposte. For nearly four decades, Tokyo had shelved requests from companies for drilling rights along the sea border for fear of rousing China's ire. But Japan has now approved the first such license to Teikoku Oil, prompting Beijing to accuse Tokyo of "provocation." China has now flexed its military muscle. Tokyo has reported the presence of Chinese warships near China's oil and gas platform twice in the past seven weeks. The Japanese have also detected Chinese intelligence-gathering aircraft and naval submarines near the fields, which the Chinese have called routine exercises of a reserve naval squadron patrolling the East China Sea. "China brandishes its military because it knows Japan and the U.S. are watching," says Kentaro Serita, a professor of international maritime law at Aichi Gakuin University. "It can easily get Japan's attention."



JUST LOOKING A Chinese drilling platform in the East China Sea



Safe to Drill?

SKEPTICAL THAT CHINA is willing to share the undersea resources, Japanese lawmakers now seem to be girding for a showdown. The ruling Liberal Democratic Party is drawing up legislation to let the Coast Guard protect civilian workers of Teikoku Oil, which says it won't start test drilling until after the government offers specific security assurances. It's hard to predict what China might do. It might send its military in a show of gunboat diplomacy...leading to a conflict," says Keizo Takemi, a veteran LDP lawmaker who has argued in favor of the legislation. An all-out war is highly unlikely. But even an accidental exchange of fire would trigger an extended crisis in Sino-Japanese relations.

Some in Japan wonder whether the fight over the fields is really worth the trouble. Transporting the gas back to Japan presents a tricky technical issue, and the risk of a clash on the high seas might scare off any Japanese energy companies interested in bidding for the business. Finally, the fields are 250-odd miles north of another potential flashpoint, Taiwan. Risky business indeed. But Tokyo, in its newfound boldness, seems ready to undertake it. ■

–By Kenji Hall, with Hiroko Tashiro, in Tokyo, and Dexter Roberts in Beijing

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CHIC ADDRESS Coach is opening a tony flagship store on Madison Avenue

Coach's Split Personality

How the retailer manages to keep both fashionistas and outlet shoppers happy

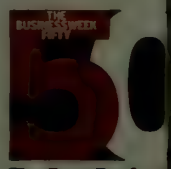
WHILE OTHER FASHION brands fret over whether consumers will reach for their wallets this holiday season, Coach Inc. is already feeling festive. On Oct. 25 the New York handbag maker announced its 14th straight quarter of double-digit growth in existing stores. Fueling that growth are customers such as New York public-relations executive Andrea Martin, who keep coming back for fresh iterations of weekend bags, wallets, wristlets, and more, often dropping hundreds of dollars to ensure that their purses match their pants each season. "It's not such a splurge for something you can use a few times a week," says Martin, who already owns three Coach bags. "The quality of their stuff is amazing."

Coach has expertly managed its brand to reinforce that upscale image. But fashionistas like Martin might be shocked to learn that the fastest-growing part of Coach's business these days is the factory store. That's where Coach sells off last season's accessories or irregular products at discounts of about a quarter off. Sales in those outlets grew 36% in the past quarter, vs. 14% in full-price stores. Overall, quarterly sales grew 30%, to $449 million. [illegible] earnings jun[illegible] 48%. Coach's [illegible]rid growth st[illegible] helped earn i[illegible] No. 17 spot on the BusinessWeek 50 li[illegible] top corporate performers.

The challenge now is to make sur[illegible] rapid growth in the bargain-bin en[illegible] the business doesn't dilute the luxury [illegible] of the Coach brand. After all, brands f[illegible] Calvin Klein to Tommy Hilfiger too[illegible] image dive when their goods drifted [illegible] far into discount channels. But that w[illegible] happen to Coach, vows Chairman [illegible] Chief Executive Officer Lew Frankfor[illegible]

LOYAL UP AND DOWN

FOR ONE THING, he has develope[illegible] strategy that strictly separates fash[illegible] forward Coach fans from the ones [illegible] love snapping up out-of-date gear on [illegible] cheap. The company's 85 factory ou[illegible] are normally located at least an ho[illegible] drive or 60 miles from its 199 full-p[illegible] stores. Because Coach never offers [illegible] counts in its regular stores or via [illegible] Web—and doesn't allow departm[illegible] stores to mark down Coach goods either—those who want bargain-priced products can get them only at outlets. And they won't get access to the latest products, which are rolled out each month in re[illegible] lar stores. Instead, they get discontin[illegible] models or older styles that are manu[illegible] tured specifically for outlets. "It all[illegible] [Coach] to dispose of items that d[illegible] work, in a very different channel," s[illegible] Kurt Barnard, president of Barnard Re[illegible] Consulting Group.



The Best Perform[illegible]

As a result, there's very l[illegible] overlap between shopper[illegible] opposite ends of the sp[illegible] trum. According to Coa[illegible] consumer research, the a[illegible] age full-price shopper is [illegible] college-educated, and a sin[illegible] or newly married work[illegible] woman. Factory outlet sh[illegible] pers are, on average, 45, [illegible] lege-educated, married, [illegible] likely to spend 80% of t[illegible] Coach dollars at outl[illegible] "They're as brand-loyal as [illegible] full-price shoppers," s[illegible] Frankfort, who notes that [illegible] let fans drop about $77[illegible] year on Coach products, [illegible] the full-price average [illegible] $1,100. "These are pro[illegible]

Coach Class

Factory outlets make up the fastest-growing segment of Coach's business, but the handbag maker avoids brand taint by keeping the bargain hunters and the upscale shoppers separate

The amount of discount Coach offers in its full price stores. Instead of cutting prices, old merchandise is moved to factory outlets	0
The average age of a full-price store shopper	35
The average age of a factory outlet shopper	45
The typical distance, in miles, Coach keeps between factory outlets and regular stores	60

Data: BusinessWeek

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sional moms who want beautiful, well-made brands at low prices." Having this fall's gold-pleated Hobo bag or coyote fur-lined pocket duffel isn't a top priority.

UPSCALE FLAGSHIPS

AT THE SAME time, those who do covet the latest fashions continue to find satisfaction in Coach. The beauty of the brand, according to Barnard, is its positioning as an ultra-luxe label that nevertheless boasts relatively reasonable price tags. Though Coach sells a python satchel for $1,900, that's a relative bargain compared with a $14,800 crocodile bag from Gucci. Coach bags typically cost around $200 to $400. Yet a lot of buyers put it alongside names such as Gucci, Versace, and Dior. What makes Coach shoppers feel like they are in the same league as those tony names are the goods' quality and eye-pleasing designs, as well as the luxurious stores where they are sold.

Shoppers rank Coach with Gucci and Dior

In order to drive home those upscale associations, Frankfort is putting chic flagship stores in some of the world's most expensive retail real estate. The company is opening massive stores this November on Beverly Hills' Rodeo Drive and New York's Madison Avenue. "The flagship serves as a beacon for the brand," says the Coach chief. Still, the bulk of stores are in more modest locations that pump out the hottest new products. That's the right strategy, says retail real estate consultant Steven Greenberg, who argues that too many companies go flagship-crazy at the expense of the bottom line. Coach, he says, "is extremely prudent."

Still, Frankfort's hopes are clearly pinned on wooing those Coach shoppers who crave the trendiest bags and accessories. He credits the fast growth in the factory channel with a fresh effort to upgrade merchandise there. He expects the number of outlets to top out at around 100, while the full-price universe easily could reach 350 stores in North America over the next several years. "Our destiny lies in our ability to grow full-price stores," he says. That's why the two new palatial flagships are crucial to Frankfort—to keep the brand image strong and sales even stronger. ■

–By Diane Brady in New York

ASLAN At the center of C.S. Lewis' magic allegory

The Lion, the Witch And the Franchise

Disney is counting on *Narnia* to reel in a audience of kids, gamers, and Christians

THE RESIDENTS OF Narnia live in an enchanted land of hope populated with talking bears, dwarfs, and fauns. But in 2001, *The Chronicles of Narnia*, the much-beloved seven-book series written by British author C.S. Lewis, was a lost cause to Hollywood studio executives.

Even as blockbuster hopefuls like *Harry Potter*, *X-Men*, and *The Lord of the Rings* were coming to life, Paramount Pictures dropped *Narnia* after five years of false starts and rising budgets. "It was a great project that couldn't seem to get going," recalls David Weil, CEO of Anschutz Film Group, the family-friendly movie unit owned by Denver billionaire Phil Anschutz that picked it up on Paramount. Anschutz, a onetime Sunday school teacher, was drawn by *Narnia*'s spiritual underpinnings. Holed-up in New York's Four Seasons Hotel for months of negotiating, Weil made an offer to C.S. Lewis' stepson that he couldn't refuse. "We laid out a 15-year plan to create a franchise out of *The Chronicles of Narnia*," recalls Weil, "and wouldn't let him out until he agreed."

When *The Chronicles of Narnia: The Lion, the Witch and the Wardrobe* hits theaters on Dec. 9, it will represent Hollywood's latest venture—and one

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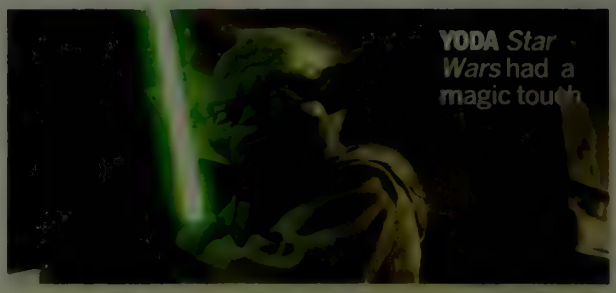
its most costly yet—to create a franchise, which is, after all, the celluloid Holy Grail. The stakes are enormous not just for Anschutz but also for Walt Disney Co., the film's distributor, which is paying half its production costs. "It was an expensive bet," says Disney studio Chairman Richard Cook, who was first approached about the project by Anschutz executives two years ago. "But with books that have as many as 90 million readers, it was a bet worth taking."

Unlike some studios, Disney in recent years has been without that signature movie that just keeps giving. Time Warner Inc. and Sony Pictures Entertainment have boosted their financials through *Harry Potter* and *Spider-Man* sequels, respectively. But Disney, which still has no new deal with its longtime animation partner Pixar Films, desperately needs a gusher. "Disney doesn't have that predictable film like a *Harry Potter* that you know will do great business at the box office and sell a ton of DVDs," says former Columbia Pictures executive Peter Sealey, a marketing professor at the University of California at Berkeley.

Still, these special-effects-driven productions can be budget-busters—the first *Narnia* will cost north of $200 million to make and market—and there is no guarantee that they will ever catch fire. Narnia, in particular, comes with a ready-made marketing tinderbox: The series is a lightly disguised Christian allegory about four children who find a magical wardrobe and are transported to an eternal world. In the film, the Christlike lion Aslan dies to protect a child but then is resurrected. Says Sealey, "If Disney markets it too heavily as a Christian film, others may take a walk."

Just the same, the makers of *The Chronicles of Narnia* have followed a detailed blueprint to assemble their franchise. Anschutz' Walden Media outfit, which is making the film, has the rights to make movies for all the *Narnia* books. It selected as its director 39-year-old Andrew Adamson, who directed DreamWorks' *Shrek* and has been a Narnia fan since childhood. And it teamed up with Disney, which will share half the $150 million production budget and deploy its fabled marketing operation to plug the film. Disney's ABC network will feature promotions appearing in the corner of the screen during its hot shows like *Commander In Chief*, says Oren Aviv, the studio marketing head. Already, the studio has sent out trailers on about 20 million DVDs, including those for the first season of the ABC hit *Lost*.

Disney is betting big on the lure of *Narnia*'s 1,600 special effects



YODA *Star Wars* had a magic touch

Films That Keep On Giving

Disney hopes *The Chronicles of Narnia* will one day join the pantheon of great franchise features

SERIES	STUDIO	DEBUT	FILMS	GROSS TIX (BILLIONS)
Star Wars	Fox	1977	6	$4.2
James Bond	MGM	1963	21	$3.9
Lord of the Rings	New Line	2001	3	$2.9
Harry Potter	Warner Bros.	2001	3	$2.6

Data: Imbd.com, the-numbers.com

FRODO The spell of *Lord of the Rings*

CHURCH SCREENINGS

A SUSTAINABLE mega-hit would give a big boost to Disney's movie unit, which lost an estimated $300 million during the summer. The studio, which has treated its animated films as big-event franchises, may soon lose its 13-year partner, Pixar Animation Studio. And before its 2003 hit *Pirates of the Caribbean*, for which it is making two sequels, it had never had a series of successful live-action films. (Ironically, its Miramax unit decided to pass on *Lord of the Rings* in the late 1990s.)

Disney is gearing up with the same kind of marketing muscle it used for its 1994 film *The Lion King*, which turned into a $1 billion business with consumer products, DVDs, and a hit Broadway show. It has licensed more than 60 products, including a $249 replica sword. But Narnia will require a masterful [illegible] keting balance among C[illegible] tians, video game pla[illegible] and Disney's core audien[illegible] family and kids.

So Disney marketers [illegible] courted every possible [illegible] stituency. They hired C[illegible] ian-identified Motive Ma[illegible] ing, the firm that helped [illegible] Mel Gibson's *The Passi[illegible] the Christ* into a hit, to [illegible] *Narnia* screenings at ch[illegible] es. Hoping to wow action [illegible] with the film's hefty speci[illegible] fects, the company host[illegible] reporting team from ga[illegible] Web site IGN on the mov[illegible] in New Zealand, from w[illegible] it filed news accounts o[illegible] Disney and Ansc[illegible] Boston-based Walden M[illegible] which works with scho[illegible] promote reading, has [illegible] shipped more than 100[illegible] teachers' editions of the b[illegible] Florida Governor Jeb [illegible] launched a contest to pro[illegible] reading the *Narnia* book[illegible]

So far, it looks as if Di[illegible] has reason to be upbeat. [illegible] ly reviews have been gen[illegible] ly supportive. After a r[illegible] screening, Internet movie site Ai[illegible] Cool News ran one favorable review [illegible] one that was lukewarm. The site's o[illegible] Harry Knowles, a trusted sage to th[illegible] fi fans coveted by *Narnia* mark[illegible] raved about the film. Disney sent sp[illegible] effects master Howard Berger with [illegible] minute segment to Knowles's sci-f[illegible] festival in Austin, Tex. "When [illegible] footage was over, the audience b[illegible] cheering," Knowles wrote on his [illegible] "My sweetie, who absolutely is gag [illegible] *Narnia*, had to go to the bathroo[illegible] touch up her mascara."

Not content to rest on early k[illegible] Disney is lining up corporate h[illegible] weights for help. McDonald's, Ge[illegible] Mills, and others are ponying up an [illegible] mated $150 million in promotional [illegible] port for the film, says Aviv—conside[illegible] record. Shopping mall owner Taub[illegible] Centers Inc. has set up wintry tabl[illegible] from *Narnia* at 11 high-end malls.

Clearly, the presell is in place. It'[illegible] movie itself that is creating the [illegible] stress now. With 1,600 special ef[illegible] last-minute editing fixes are runnin[illegible] hind schedule to deliver a final print [illegible] now curtains up on the drama of Dis[illegible] long-awaited franchise. ■

–By Ronald Grover in Los An[illegible]

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As Corporate America enters Year Three under SOX, BusinessWeek Special Advertising Sections asked a group of experts with different specialty areas to brainstorm on the perils and promise of organizing for compliance. Their insights, expressed in a virtual roundtable discussion that's excerpted below, may surprise you.

Sarbanes-Oxley has become a top issue for many business executives in the last year.

John Hagerty: Companies have done a lot of work in getting Year One done. One of the things that we heard almost from every company we spoke to is that the "brute force" method was used for Year One. Organizations just did what they had to do under the directive from executives. And what that meant was that there was a large amount of manual effort.

Did some companies go a bit overboard in their scramble for the finish line?

Doug Barton: Yes, but this is only apparent in hindsight. In retrospect, companies were able to recognize they perhaps spent more time in areas with less impact on the total control environment than they should have. In fact, some companies performed rigorous documentation, testing, and assessment of controls in regions with an immaterial amount of business revenue or expenses for an enterprise.

Are the costs of compliance higher than some executives expected?

Warren Stippich: In some cases that's absolutely true. As the Year One filers were wrapping up their project a year ago, many thought that the percentage of the dollars and efforts spent for Year Two would be much less than what they spent in Year One. As Year Two has moved into full swing, it became apparent to many of those companies that – due to changes in their business – the effort to re-document those areas impacted by change has caused the number of hours and the efforts to go right back up again.

Participants: John Hagerty, Vice President, AMR Research • Doug Barton, Vice President, Product Marketing, Cognos Performance Management, Cognos • Warren W. Stippich, Jr., CPA, CIA, Partner and Practice Leader, Business Advisory Services, Grant Thornton • Daniel B. Langer, CPA, CIA, CCSA, Solutions Director, Internal Audit and Controls, Jefferson Wells • James Howard, Manager, Compliance Controls & Quality Assurance, DTE Energy • Deborah Hamilton, Senior Director, Applications Marketing, Oracle • Albert G. (Gerry) McGrath, Jr., Partner, Baker & McKenzie

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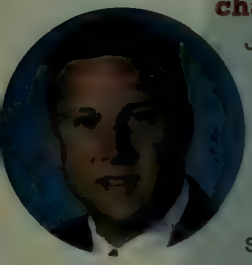
From a service provider's perspective, how are companies moving forward from those first-year efforts?

Dan Langer: We are seeing a segment of clients that went through the Year One experience beginning to get more efficient and focused in their process. They're adopting more of a risk-based approach to prioritizing areas of emphasis and re-scoping their organizations to identify key control areas. Some of them have actually shifted and decided they need to engage process owners to a greater degree. So they're employing control self-assessment practices where process owners assess their own control environment more effectively, having internal audit monitoring controls rather than coming in and looking at the controls as management would. What we've also seen is our clients are getting smarter about engaging third-party resources like Jefferson Wells, professional service firms with the core skills to help, ensuring the right people are engaged as needed, and keeping that partnership going so that the people who become familiar with their organization stay engaged with them and help them year to year with their efforts.

How did DTE approach all of its compliance challenges for Year One?



Jim Howard: DTE Energy began the process in 2003. Evaluating our internal controls was a large effort, which required a project-oriented focus. Due to the timing for completing 404, we undertook a "forced march" approach for Year One in many respects. In order to be successful and sustainable for the long term, we realized that the project was going to have to turn into a process at some point. DTE Energy structured the approach by creating committees, teams, and individual contributors that performed the controls. We reviewed, and in some cases, enhanced our policies and procedures. We recognized that key controls needed to be embedded into procedures so that employees had an understanding of the expectations for compliance with internal control over financial reporting. As a result, the revised policies and procedures created a need for cultural change.

With more than 200 DTE companies, there was a sense that not all processes and controls were equally important. We were able to develop a top-down, risk-based approach to identify significant business processes and related controls. Although DTE Energy had to remediate several key controls, when we filed our 10-K for 2004, we were satisfied that the infrastructure was built to ensure sustainable processes going forward.

Hagerty: Originally, a lot of companies thought that Year One would be the brute-force method and Year Two would be the year of automation. We're definitely seeing a lengthening of this process. Year Two is now a year of reassessment. Then Year Three and beyond will be the years of automation. We're seeing people stretch out the process for justifiable reasons to make sure that they're not doing too much and are doing the right things for their company.

How are compliance tools being rolled out to support this effort?

Deborah Hamilton: We've seen companies take a phased implementation approach. For those that purchased tools to help with SOX compliance, it was typically finance that used the tools to document internal controls in Year One. Now IT is considering technology to automatically monitor and test system controls. In other cases, even if finance purchased and selected the tool, they were so focused on just compliance that they didn't have the resources to implement the tool. It went to IT, and IT ended up rolling out the technology first.

Langer: We did a survey this summer on tools and the extent to which clients were employing them. No single vendor was servicing any of our clients to greater than 7% of the total. So there is no dominant player in this market right now. We asked clients what they've gotten out of the tools so far: the single greatest benefit to date was helping to standardize documentation.

What about the legal aspects of compliance?

Gerry McGrath: The Securities & Exchange Commission (SEC) is encouraging public companies to take a top-down, risk-based approach to what's important. The SEC is trying to focus companies and their auditors on the need to avoid a mechanical approach and encourage each to think about the processes as they go through this year of reassessment. In addition, guidance provided by the SEC and the Public Company Accounting Oversight Board (PCAOB) encourages companies to focus on what's important. Companies don't have to tie down areas that present a low risk. The SEC and PCAOB have encouraged auditors to use professional judgment to determine whether there is reasonable assurance as to the financial statements.

How can companies create practices that are sustainable, repeatable, and cost-effective for Year Two?

Stippich: Setting aside the technical aspects of the rules for a second, a basic thing that can help is better planning. Subsequent-year planning needs to start before the current

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year is out. Identify the areas that need to be examined, the scope, time lines and calendars, and the team. In many cases, we're seeing changes on the team, both internally and externally – whether it's a burnout due to the schedule or travel demands, a technical enhancement that you're looking to make, or an IT skill that you want to bring in.

Where have companies been willing to invest in compliance tools so far?

Barton: First, companies want to turn the project focus of initial Sarbanes-Oxley compliance into a sustainable, efficient program. There are a number of smart technology investments that revolve around better visibility to the control environment, such as reporting on controls by entity, by process, sub-process, and control objectives. Second, we've seen systems renewal in an effort to remediate key control weaknesses around financial consolidation and reporting – fixing manual, labor-intensive processes as well as control weaknesses. The third area is a perception that these compliance investments need to provide a performance-improvement dividend to create a more effective and efficient business.

What is the relationship between compliance, governance, risk management, and, ultimately, performance management?

Barton: Compliance improvement is about speed and integrity; faster cycles of corporate reporting can drive faster cycles of scrutiny, review, planning, and decision making. This is an opportunity for finance and business management teams to reflect upon the speed of their corporate decision-making and risk-management practices, resulting in targeted investments that drive integrity, relevance, and timeliness into their information systems. In a more dynamic decision-making environment, businesses can quickly respond to opportunities and threats, resulting in a new level of corporate agility that helps sustain competitive advantage over the longer term.

What were the key lessons learned after Year One?

Langer: One of the key disclosures ties into the filings that came out after Year One for accelerated filers. Many of the disclosures were focused on tactical accounting and finance-related matters, particularly in areas such as taxes and leases. The governance-related weaknesses that were surfacing through the filings were surprisingly infrequent. A Jefferson Wells survey revealed that between 65% and 75% of the respondents felt that the audit committees and senior management need to have a greater awareness of fraud risk assessment and monitoring fraud responses and activities related to that area. Since Sarbanes, there are more frequent board meetings and governance meetings. The internal audit function is more involved with the audit committee. But there's still a maturation of communication to governance and senior management needed in terms of awareness of fraud and potential ethics violations that surface.

Stippich: There also needs to be a project management focus and strong discipline and task masters that hold the deadlines in place. In organizations where this wasn't the case, or where management fought its being brought in (or being given timelines and deadlines and follow-ups and meetings and agendas and action items), those organizations struggled quite a bit. Without that discipline, it put them behind the eight ball. And then on the other side are the detail controls. And there are a lot of lessons learned on the detail. Clearly there are some complex areas where lessons were learned, and people are trying to beef that up.

What about from a legal perspective?

McGrath: The relationship between the outside auditors and management underwent some changes over the last 18 months as a result of responsibilities placed on auditors. There were inhibitions with respect to communication between the auditors and management, which frankly led

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Providing decision makers with a detailed, yet digestible view of critical compliance indicators is no small challenge. "These stakeholders need to see key risk indicators, controls and the testing of those controls, risk-management processes, unexpected losses or incidents, and the automation of system events," says Ken Williams, vice president of technology services for Computer Associates Inc., in Islandia, N.Y., "and they need this information without delay."

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to some unfortunate situations. Management was concerned about asking questions of their auditors that might be viewed to be evidence of deficiencies or weaknesses in the system. On the other hand, the auditors were concerned that communication would raise questions about their ability to maintain independence, which is essential to this process. The SEC and PCAOB noted this issue in their respective policy statements issued earlier this year and have encouraged communication, which is viewed as beneficial to the company and its shareholders.

What recommendations can we offer BusinessWeek readers?

Hagerty: When you consider compliance, think about repeatability, sustainability, and cost-effectiveness. Our first recommendation is to increase investment in technologies that automate the testing of your controls. The second area is to help people understand what's going on in the business by investing in portals, dashboards, and scorecards for better visibility. And third, don't reinvent the compliance process. Refine it and then start to automate it.

How about from a technology perspective – what are companies' next steps?

Hamilton: Companies are certainly investing in new technologies, but they are also optimizing what they have in place. They're looking at their ERP environments and seeing how they can enhance segregation of duties and security, configure the system to automate more controls, and then leverage some of the reporting capabilities they have in place, such as audit logs and exception reports. For customers that have already purchased a risk-management tool, many of them are turning on more of its functionality so they can automatically test internal controls or manage different types of audit engagements. And then we're seeing companies expand the number of users who have access to the tools – whether those users are from IT, finance, or the lines of business.

Howard: Having a strong discipline around change control going forward will be critical as well. If you can create an infrastructure that establishes a baseline for your controls, then you can begin to measure changes to processes and controls. As a result, the overall process for evaluating controls can be reduced, including the amount of testing required. At DTE Energy, we are striving for an evaluation model that utilizes continuous monitoring of controls.

Hagerty: That's a great point. Sustainability is all about making sure folks understand what change is, what change will be allowed, and how you monitor change. Also, companies that work well with others do the best. You've got to have everyone at the table to make sure you're cogently and rationally looking at what you need to do. Then start creating a repeatable set of activities. The last piece is looking at this in the long term. Some folks have approached compliance as a tax to the business; therefore, they're going to do whatever they can to avoid costs. Those who are most successful look at it as a long-term cost-reduction opportunity. But it requires them to spend some money in order to gain more money later.

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For More Information

A discussion of the state of corporate governance in the global marketplace, with senior government and industry leaders, is scheduled for Dec. 6, 2005. This corporate governance policy discussion is sponsored by Harvard Law School's Program on International Financial Systems, Standard & Poor's, and BusinessWeek, in New York. For more information, contact mgreven@law.harvard.edu or call Melissa Greven at (617) 495-9885. Panelists will include SEC Commissioner Paul Atkins; President of the German Federal Banking Supervisory Office Jochen Sanio; S&P corporate governance global practice leader George Dallas; BusinessWeek senior editor John Byrne; and others.

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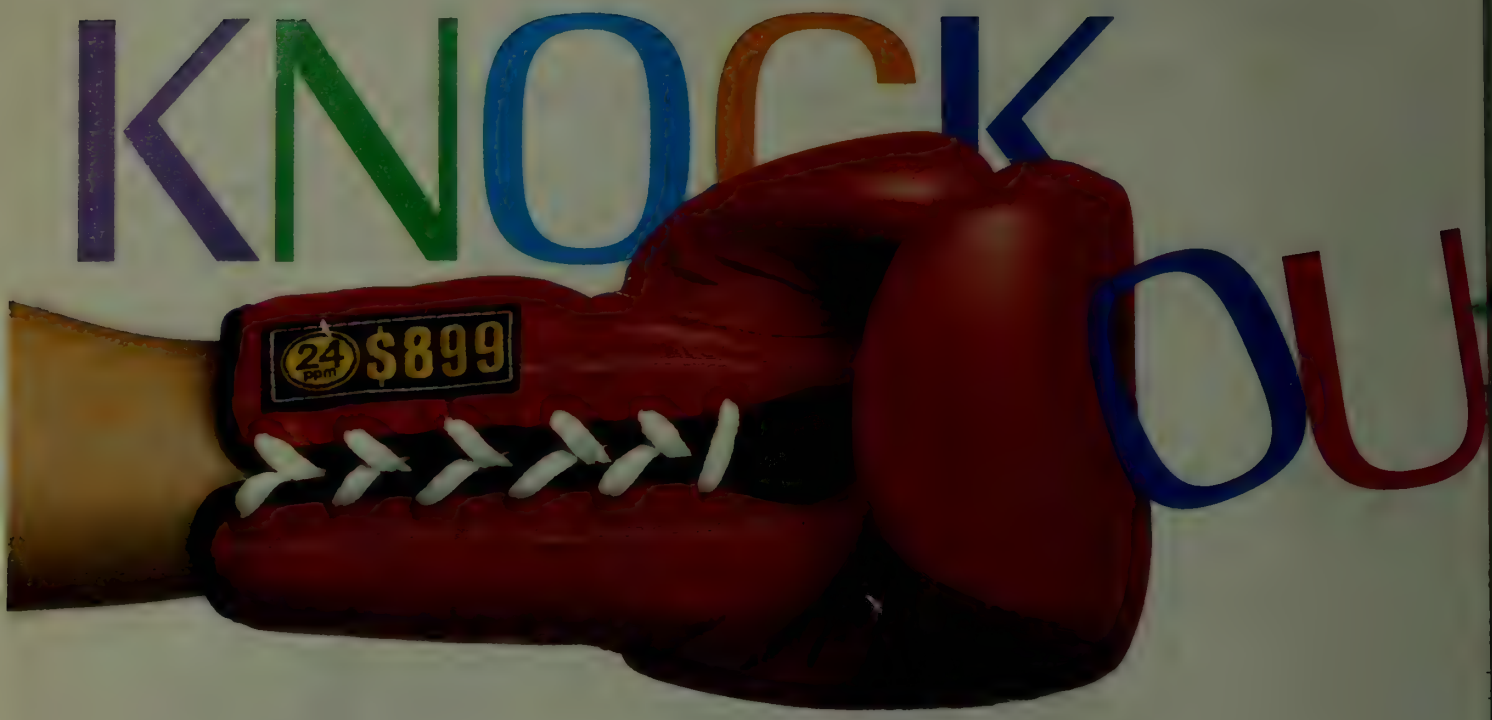

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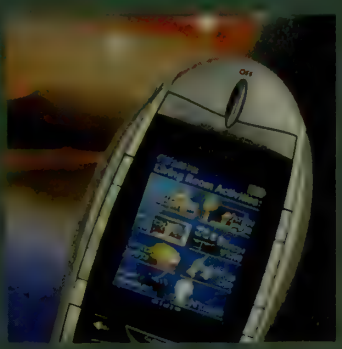
BusinessWeek

TECH BUYING GUIDE

The Digital Home



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BusinessWeek weekend We devote our entire weekly TV program to the Tech Buying Guide. Check your local TV listings to watch *BusinessWeek Weekend*.

DIVE INTO HDTV

With prices way down, now's the time to jump into the world of big, crystal-clear T

By Cliff Edwards

SOME TV MOMENTS YOU never forget: J.R. getting shot. The space shuttle Challenger exploding. In the world of high-definition TV, there's a more recent one for me: Northwestern University's football upset of then-undefeated University of Wisconsin that I watched Oct. 8 on ESPN HD. On LG's $5,000 50PY2DR, every detail stood out as I enjoyed my alma mater's 51-48 triumph—from the concern on the Badgers' defensive linemen's faces after a last-minute turnover to the jubilant expressions of Wildcats fans as the clock wound down.

With HDTV, great moments are crystal clear. And thanks to prices that have fallen dramatically over the past year, now's the time to jump feet-first into the market. I've checked out the latest HD sets, 37 inches measured diagonally and larger, looking at plasmas from Hitachi, LG, Panasonic, Pioneer, and Samsung, as well as liquid-crystal-display sets from Dell, Sony, ViewSonic, and Toshiba. I've looked at projection units from RCA and Epson using Texas Instruments' "digital light processing" (DLP) technology. I even considered conventional cathode-ray-tube-based sets from Philips and others that offer great pictures and cost less than $1,000. The good news: Many manufacturers are packing in new goodies such as built-in TV guides, digital video recorders, and processing technology to make even analog pictures look better.

In the world of big TV, you first need to determine which size screen fits best in your room. The HDTV sweet spot is 42 inches, applicable to many living rooms and bedrooms. But some family rooms might comfortably fit a gargantuan 82-in. screen such as Mitsubishi's $11,000 WL-82913 liquid crystal-on-silicon rear-projection display. A rule of thumb: You should be 6 feet to 9 feet away from a normal to midsize set showing an HD broadcast. You'll want to sit a foot or two farther out to watch shows still broadcast in analog form, which makes images appear grainy on a big screen. Some sets, such as Samsung's $4,600 50-inch HP-R5072 plasma TV and Sony's 32-inch $2, KDL-V32XBR1 Bravia LCD TV, incl technology that "upconverts" analog make it look less grainy. For sets with that technology, I recommend Belk $249 PureAV RazorVision video ca which performs the same function.

More Level Field

DON'T GET HUNG UP on the techno gies—all offer great pictures. And th are fewer technical downsides to cho ing one over another. Most plasmas n imperceptibly shift the picture on screen, lessening the chance of "burn-i in which static images such as pau game scenes or station logos appear ghosts that can't be erased. Pay no att tion, also, to the myths about their lac longevity; most plasma sets will live v beyond seven years even if you have th on eight hours a day. The big knock ab LCDs—their hefty price tag—is no lon as relevant. New ones 37 inches a smaller cost less than $3,000. Big ones cost more, but the gap is narrowi Even tube-based sets offer great pictu

though they take up more room because they're not as svelte as LCDs or plasmas.

While plasmas are known for their brilliant colors, I'm impressed with improvements on the LCD front. Watching the movie *Hellboy* on Toshiba's 37HL95 LCD TV, the colors looked so vivid and the contrast so bright that I had to check the box to make sure the set wasn't a plasma. The downsides? Plasmas still consume more energy, while pictures on LCDs and rear-projection sets don't look as good when viewed from extreme angles.

Even with much-improved displays, all screens are not the same. Look at the last number in the resolution bracket, usually found next to the TV display in a store. If it's above 720, the set is capable of displaying HD programming. There are two common broadcast formats: 720p or 1080i. One is not necessarily better than the other; 1080i, or interlaced, has more lines and pixels, but 720p is a progressive-scan format that should deliver a sharper image of a subject in motion. Some LCD and DLP sets now offer 1080p resolution—a good choice if you're thinking of upgrading in the next year or two to the new high-definition DVD players that are expected to hit the market.

Think Ahead

ONE OF THE MORE important decisions you'll make in buying an HD-ready set is connectivity to other devices. I always recommend buying a set with at least one, and preferably two, HDMI, or high-definition, multimedia inputs. You can cut down on cable clutter with HDMI, which keeps the image the highest quality by sending uncompressed high-definition video and audio down a single cable. Because HDMI also carries software to make sure content isn't pirated, many future devices, such as Sony's PlayStation 3 and next-generation DVD players, will include HDMI, so it's better to try to future-proof your set now. Some sets with two HDMI connections: Dell's $3,800 50-inch W5001C plasma, as well as models from Pioneer and Hitachi. Gefen also sells a $400 box that lets you plug four HDMI-equipped set-top boxes into one display.

Don't let low price hoodwink you into buying an enhanced definition TV, or EDTV. They're good mainly for playing DVDs and won't show HD content as clearly. What's more, industry leader Panasonic's glitzy TH-42PX50U high-def plasma now costs just $2,800—about $2,000 less than a more or less identical set a year ago. So if you're really just looking for something to show DVDs and want a big-screen experience, I recommend Epson's MovieMate 25 or RadioShack's Cinego all-in-one home ater DLP projectors, which retai about $1,200. These units project th age on a wall or a screen.

A last word of advice: Make sur know your retailer's return policy while I generally recommend an ex ed warranty, be clear about what covers. An early production model LG plasma I mentioned earlier, came with a built-in hard drive, ha of software problems that caused glitzy set to turn itself on suddenly. placement the company sent worke fectly, but it was unsettling to learn LG handles repairs and replacement case-by-case basis, as opposed to jus ing a set back for any reason.

Whether you choose DLP or pla LCD or projection, do your homev While you won't be hanging out your new HDTV set for life, you will it to be around to make many yea digital memories. ■

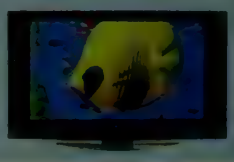
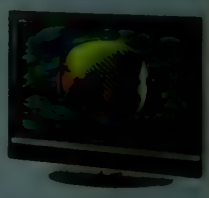
COOL TOOL

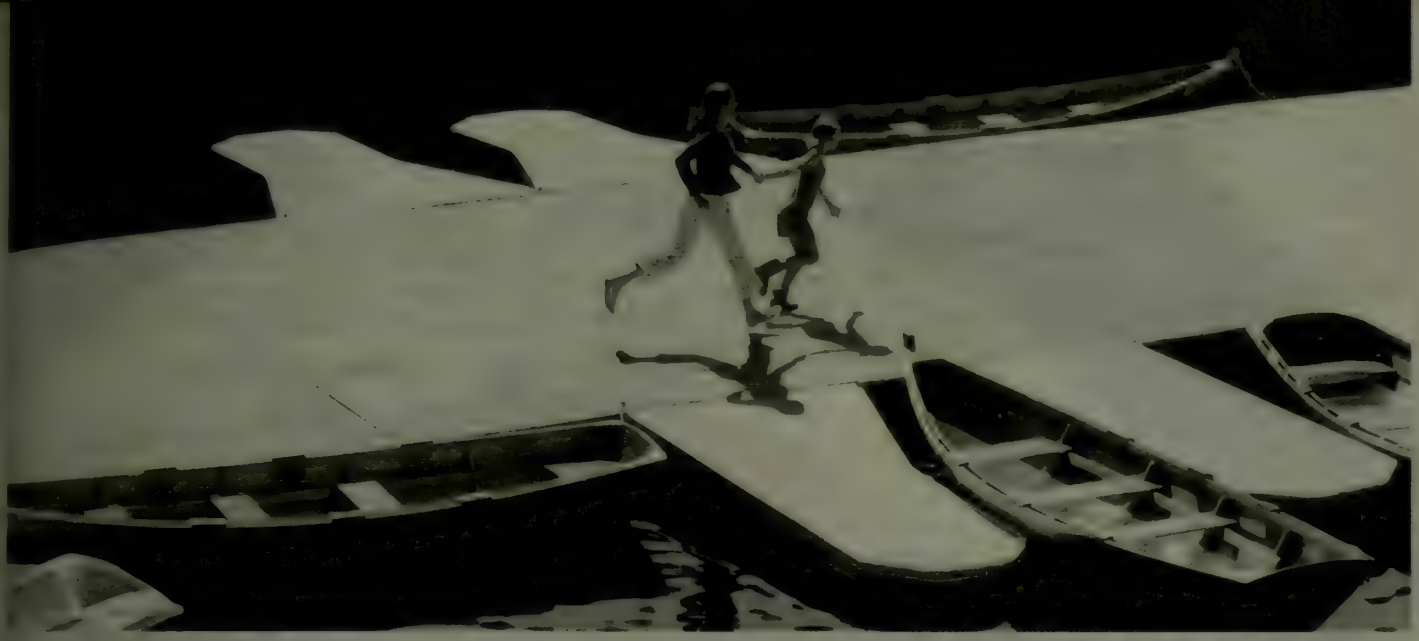
BELKIN PURE/AV RAZORVISION
$249
belkin.com

Looking to bridge the quality gap between standard-definition television and HDTV? This gadget "up-converts" poorer-quality pictures using either high-definition multimedia or digital-visual interface cables. In the connectio between the display and cable, satellite, TiVos, and other set-top boxes, the device boosts contrast and makes images look crisper.

SUPERSIZE YOUR PICTURE

They're still not cheap, but HD sets are no longer in the stratosphere—and they'll make your home theater rock.

MODEL/ URL	EPSON MOVIE-MATE 25 (3LCD) epson.com	LG 50PY2DR (plasma) lge.com	SAMSUNG HL-R6178W(DLP) samsung.com	TOSHIBA 37HL95 (LCD) toshiba.com	SONY BRAVIA (LCD) sonystyle.com
PRICE	$1,200	$4,999	$4,500	$2,400	$2,700
SIZE	Up to 80 inches	50 inches	61 inches	37 inches	32 inches
THE GOOD, THE BAD, AND THE BOTTOM LINE	Good enhanced-definition system for movie buffs and gamers, but it has no television tuner	Built-in digital video recorder and TV guide; returns ccepted on a case-by-case basis 	One of the few sets that can display full HD plus multiple inputs, but it needs a huge room	Excellent picture and good fast action, but remote looks cheap	 A crowd-pleaser that delivers nice pictures at a competitive price



I called the office after I sent the e-mails AND I shrieked as we ran to the end of the pier, in a mad rush to do nothing at all.

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MUSIC, LIGHTS, ACTION WITH ONE CLICK

Devices that let you control many appliances from your couch are increasingly accessible—and affordable. **By Cliff Edwards**

HOW CAN YOU BE A PROPER couch potato if you have to get up to pull down the shades, flick on the lights, turn up the heat, turn off the oven, and see who's at the door, all the while fiddling with the controls on your home-theater system? The answer: Make your home smarter. Thanks to the digitization of many consumer-electronics products and the rise of personal Wi-Fi networks, you can buy a wireless system for little more than $400 that will let you control many of the moving parts in your home from a touchscreen pad or remote device.

Recently I tested four home-automation technologies. My conclusion: They are simple enough that most of us won't need a network engineer to use them.

The most elaborate setup I sampled required an installer, and came from Salt Lake City-based Control4. The company makes equipment that uses your wired and Wi-Fi Ethernet connections to organize audio, video, climate, and ligh into a single user-friendly remote de or several wall-mounted LCD scr throughout the home. I had the inst equip my media room and bedroom units to control my entertainment tems and lighting. The equipme touchscreen pad and remote devic control media with infrared blas wireless lighting keypads, and a sm mini-touchscreen in the bedroom. gether, it cost about $4,000 and took over three hours to install and progr

Like most of the newer technologies, : system requires you to program infor- ıtion about various devices on a PC and nsfer the data to the controllers via B cable or Wi-Fi. The choices are daz- ıg: To roust me out of bed, the installer ɔgrammed my bedroom lights to come at 5:30 a.m., and my music system to y my favorite tunes from MP3s stored an iPod connected to the Control4 sys- n. The optional 10-inch tabletop touch- een to control the entire system was far ndier than the complicated remote that s included. With its bright icons, I can in a comfy chair and use the touch- een to turn on my 50-in. LG plasma , see cover art from DVDs stored in a)-disc Sony changer, and start watch- TV, all in seconds.

impler Hub

S DEFINITELY COOL stuff, but sup- e you want something simpler just to the home theater? A good middle- ınd choice is Universal Electronics' voSL remote. Essentially a souped-up ndows CE Computer, the $800 device s Wi-Fi and infrared to control MP3s, otos, and videos on your PC; digital- sic hubs; TVs, and set-top boxes. An l-on product, the $300 NevoLink Wi- ıub, helps expand the universe with a dozen more infrared flashers that can operate compatible electrical appliances.

The übersleek design includes a 3.5-in. touchscreen and 22 relatively easy-to-figure-out buttons. Even so, it took several tries to find the home button on the side of the remote, which takes you back to icons representing all the devices you want to control. But the customization was so simple, with the ability to quickly flip to your favorite channels and device settings, that even a child could use it.

While not as glitzy as NevoSL, you can also try Logitech's new Harmony 890 Pro remote, which retails for just $450. Essentially a follow-on to Logitech's popular 880 model, the 890 Pro adds new technology from Zensys, a chipmaker that created a technology called Z-Wave. The wireless system sends signals over a largely unused radio spectrum to a base station, which then blasts infrared signals to any components in that zone. Just press a button, say "watch a DVD," and on comes your set and DVD player. The 890 also can control other home automation technology using the same Z-Wave chips. Carrier and Honeywell, for example, are adopting the Z-Wave capability for home appliances.

With the Harmony remote products, you can do much of the programming yourself on Logitech's Web site: You plug in the model numbers of your components and how you use them. It took me about 30 minutes to program remote functions for eight devices, including TVs and digital video recorders. The color display, at 1.5 inches, was the smallest of the systems I tried, but still easy to read.

Finally, I tried Smarthome's Insteon, the successor to the popular X-10 home automation gear that has sold more than 10 million units. Insteon uses Powerline technology and radio frequencies so devices can talk to each other, shuffling data from one to another until they reach the right device. The $100 wireless lighting kit I used was simple to set up, with a push-button tabletop controller to turn lights on and off and dim them. I found the equipment a little bulky, but a perfectly suitable alternative. Insteon also sells a $200 kit for controlling appliances, heating and air conditioning, and alarms.

Until recently, the home automation market has been worth less than $450 million annually. That's mainly because retrofitting the millions of older homes involved tearing through walls to snake in cables. With these new technologies, and more in the works, such as wireless video-camera systems from companies like WiLife, you can send your basket of remotes into early retirement. ■

COOLTOOL

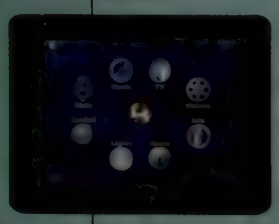
LUKWERKS
$249
Wilife
wilife.com

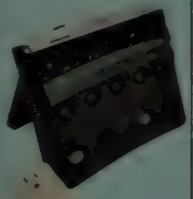
With this video-surveillance system, home is where the Internet is. You can hook up to six of these clever cameras together to let you see what's going on at home from any Web-enabled PC, phone, or PDA. Its fast, easy setup makes this a snap even for newbies.

THE SMARTER HOME

ıe growth of wireless home networks is making it easier and cheaper to ansmit entertainment programming all over the house and to control many ɔmmon systems remotely from a central point. Here's the gear:

ODEL/ ıL	Control4 Home Theater Controller control4.com	Logitech Harmony 890 Pro Advanced Universal Remote logitech.com	Smarthome Insteon Wireless Lighting Starter Set smarthome.com	Universal Electronics NevoSL Universal Controller uei.com
ICE	$1,195	$450	$100	$800
E GOOD, E BAD, THE OTTOM LINE	This affordable component can control movies, music, and lighting; it requires a professional installer	Like all Harmony remotes, you program it over the Internet; this one is the first to use RF signals to control equipment in multiple rooms	It takes just minutes for the do-it-yourselfer to control two lamps with this kit, but you'll need add-ons in larger homes	This supersmart remote aims to control your entire home; it's pricey, though, and requires a professional installer





ısinessWeek. CNET.com

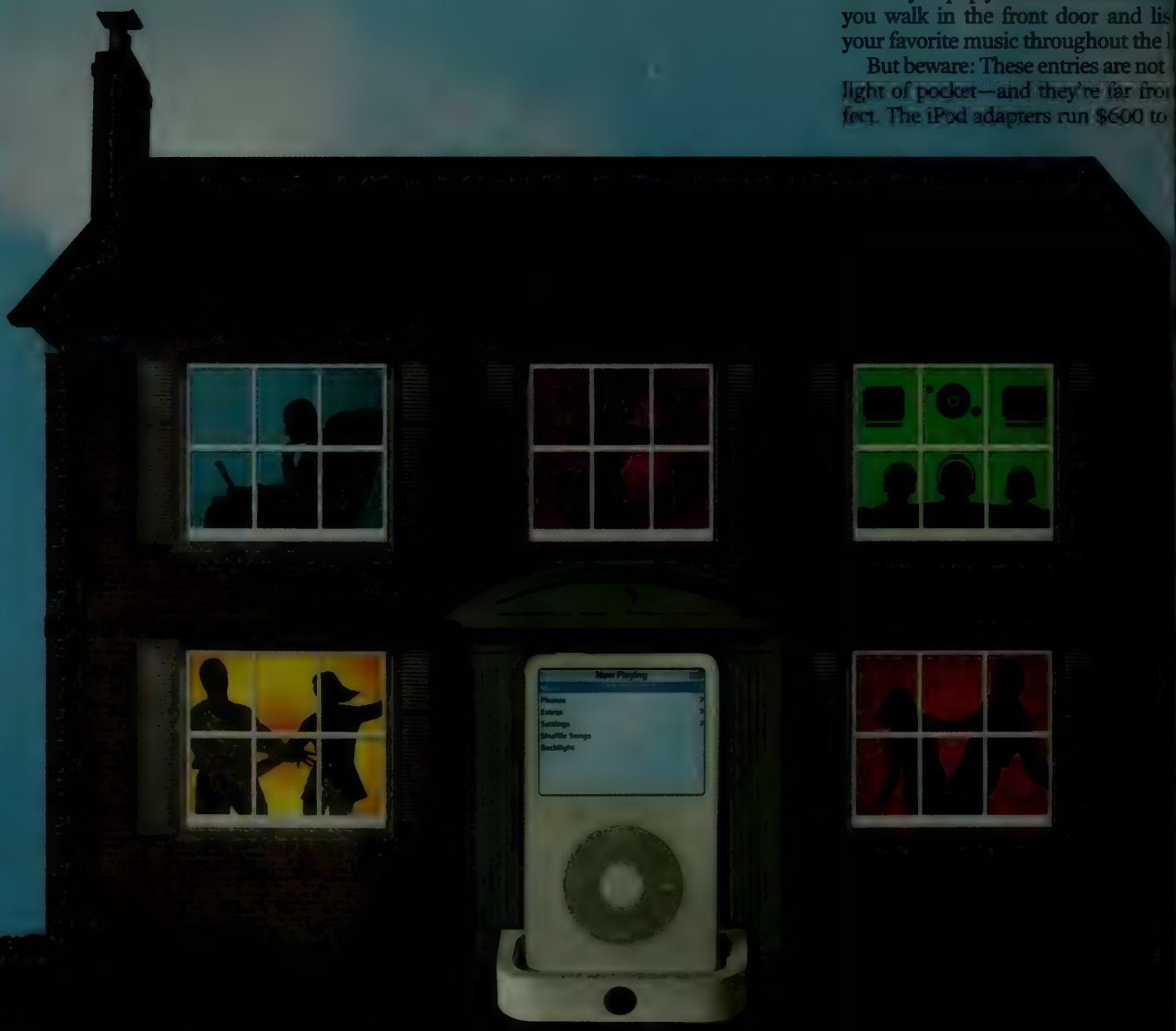
THE HOUSE THAT iPOD BUILT

High-end audio makers are scrambling to deliver gear that lets your iPod bring music into every room. **By Jay Greene**

FOR AUDIOPHILES, Computer's iPod has been a conundrum. slick-looking device th gadget freaks salivatin the iPod is an island of miles away from the sionally installed audio systems th music into rooms throughout the There has never been an elegant bridge the two worlds.

But, like car- and home-stereo before them, the companies that high-end audio gear are starting t on the iPod bandwagon. Their " home" systems have long allowed listen to music in any room of the and remotely control tunes using or keypads that can turn up the so the bedroom or turn off speakers den. Now they're coming out with that let you pop your iPod into a dock you walk in the front door and lis your favorite music throughout the

But beware: These entries are not light of pocket—and they're far fro fect. The iPod adapters run $600 to



nd that's just one piece of the puzzle. To nake the adapters work, you need to plug hem into systems that include amplifiers, peakers, touch-pad remotes, and distrib-ted audio servers that let you play what-ver music you want in whatever room you appen to be in. These whole-home sys-ems start at about $5,000 and can easily un into the tens of thousands of dollars.

The sound invariably rocks, since no ne who is spending that much money on udio gear is going to skimp on speakers r amplifiers. So the best way to compare Pod adapters is to evaluate their ease of se. The iPod's brilliance, more than any-ning else, lies in the elegance of its navi-ation. It's a breeze to zip through thou-ands of songs to find the right one in a hatter of seconds. For any whole-home udio system to measure up, users need be able to pick and choose music as if he iPod were in the palm of their hand.

Only one of the three systems I tested net that benchmark—Crestron's $700 EN-iPod. And it did so only because it as hooked up to a 15-inch touch-screen nonitor, also made by Crestron, that costs 12,000. And that's for one monitor. To lly use your iPod throughout your home, ou would need a monitor in every room here you want your music. (Crestron also fers touch-screen monitors starting at ,250 for a 3.6-inch screen.)

The CEN-iPod won't be available until larch. But if you have the money and the nkering for iPod everywhere, it's worth e wait. At the center of the touch screen an oversize image of an iPod. To navi-ate through your collection, you can tap e Menu button on the screen with your nger. Up pops listings for artists, al-ums, and songs. Spin your finger ound the scroll-wheel part of the pic-re, and you're zipping through your usic. Pretty slick. To play a tune, you can ess the center Select button. Or you can do something you can't even do on an iPod: tap the song name onto the screen to start the music.

COOL TOOL

iZ
$40
Zizzle
www.zizzle.com

Seems impossible, but one iPod accessory category has been largely overlooked: the iPod toy. Enter Zizzle, with iZ, a gizmo that looks like the love child of an unholy alien-Smurf union. Connect an iPod to iZ and he grooves to the sounds, lighting up, spinning his eyes, and chiming in with various, and sometimes impolite, sound effects.

A Sea of Songs

NAVIGATING AN IPOD using the iPort IW-3 is much more of a challenge. That's because the $600 device I tested was connected to an in-wall keypad with limited capability from audio-equipment maker Sonance. It just wasn't designed to wade through thousands of songs. Rather, the tiny screen—roughly 1 inch by 2 inches—was intended to let folks do basic tasks, such as starting and stopping music or adjusting the volume. But if you're up in the bedroom and want to switch from Billy Bragg to Green Day, you have to trudge back downstairs to the iPod itself to make the change. iPort does make another device that connects to touch screens made by Crestron and others, but didn't make it available to review.

Audio Design Associates's iBase tries a little harder to help you pick and choose from an iPod music library. But it comes up short, too. The $800 iBase I tried connected to an Audio Design preamplifier that's wired to its own controller. To manage the entire hi-fi system, Audio Design offers a 28-button remote with a one-line alphanumeric display that you place on an end table.

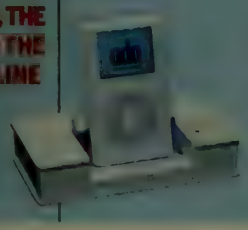
The challenge came when I wanted to swim through the sea of music on my iPod. The controller buttons aren't designed with the iPod in mind. So users have to press the fast-forward and reverse buttons to move up and down through lists of artists, songs, or albums. I have 4,200 songs on my iPod from more than 500 artists. To get to a band with a name in the middle of the alphabet—Los Lobos, say—literally took minutes. You can turn off the controller and navigate using the iPod itself. But that means that, once again, you have to go back to your iPod to change tunes.

In its brief life, the iPod has evolved from a cool way to hear music through headphones to a portable music library that snaps into car stereos and portable speaker systems so you can play your favorite music just about anywhere you want to hear it. The iPod hasn't conquered whole-home audio systems yet. But a few more gadgets like Crestron's CEN-iPod, and it will. ■

STARTING TO SHARE THE SOUNDS

As always, the first products to market are promising, but they have major drawbacks.

MODEL/URL	Audio Design Associates iBase ada-usa.com	Crestron CEN-iPod crestron.com	IPort IW-3 iportmusic.com
PRICE*	$800	$700	$600
THE GOOD, THE BAD, AND THE BOTTOM LINE	ADA's cumbersome keypad interface makes trolling though your iPod music collections arduous and time-consuming.	This easy-to-use adapter hooks up to a touch screen that mimics the iPod's scroll wheel, making it a snap to find any song. But that touch screen can cost $12,000—and you need one for every room if you want to control the music from wherever you are in the house.	A wall-mounted iPort dock in five models to match different budgets; works with audio systems from a variety of makers.



*price for adapter only

Data: *BusinessWeek*, company reports

POINT, SHOOT, AND SEND

Kodak's and Nikon's Wi-Fi cameras are vital steps toward models that zip photos anywhere. **By Larry Armstrong**

IN AN IDEAL WORLD, A WIRELESS digital camera would be as connected as a cell phone. It would let you beam pictures to your computer or online photo account whenever or from wherever you take them.

The two Wi-Fi cameras I've been trying out for the past few weeks are convenient, but they don't offer that universal connection yet. Instead, they must be in range of a Wi-Fi hotspot for you to shoot and ship. The big difference between the two: The $600, four-megapixel Kodak EasyShare One can connect to the Internet and works from any hotspot, whether it's a Starbucks, the airport, or your home. The $550 eight-megapixel Nikon Coolpix P1 and its five-megapixel sibling, the $400 P2, can't transmit to the Web and are mostly limited to the Wi-Fi network in your home. Even so, they're real cameras, with multiple picture modes and zoom lenses, that take photos far superior to the washed-out dreck most camera phones produce.

Not surprisingly, the Kodak wins out for its versatility, despite its lower resolution and higher price. With this camera, you can't e-mail your photos directly to people, but at least it lets you connect over the Internet to Kodak's EasyShare Gallery, formerly called Ofoto. You can upload your shots and, from there, still using the camera, e-mail links to them to friends. Recipients have to join the site to see them.

Once you install a Wi-Fi card (Kodak was going to sell it as a $100 option but now it comes in the box), the camera searches for hotspots and lets you pick one. I connected easily over my home network as well as at T-Mobile hotspots at a Starbucks in Hollywood and at the Burbank airport. T-Mobile charges just $4.99 a month for wireless access to your photos through its hotspots, a terrific deal.

Here's another feature I liked: With its huge three-inch screen and 256 megabytes of internal memory, you can use the camera as a digital photo album. Even without a memory card, it will hold about 150 pictures. Once you upload them to your computer, it will retain up to 1,500 low-resolution copies. If the pictures you want to show off aren't on the camera, you can wirelessly download them from your online albums. One downside: The battery will give out after about an hour of wireless activity.

The Nikon is more of a one-trick pony. Its Wi-Fi connection is really just a cable replacement, a way to upload your pictures to your computer or printer (with Nikon's $50 Wi-Fi printer adapter) when you get home. But while you're within the 300-foot-or-so radius of your hotspot and you snap off shots, they move automatically to your computer or printer.

For the wireless connection to work you've got to load the Nikon software on every computer you want to use it with. The process also involves hooking up the computer to the camera by cable once so it can store a profile of the connection. For each one, I had to type in the network number and pass code, details that can be difficult to find even on your own computer. The camera will store the connections for up to nine computers, but good luck getting your friends to let you profile their computers and networks.

I set up my laptop to run a slide show of Nikon's PictureProject software and as I clicked away, the new shots joined the show in progress. Hook up your laptop to your big-screen TV and you've got a great party trick, as well as prints to give away.

The temptation is to think of the—especially the Nikon—as novelty cameras. I think they're the first step toward a new era that connects anytime, anywhere. Don't wait till next year. ■

BusinessWeek weekend We asked tourists to try some of these Wi-Fi cameras. Watch their comments and our review on BusinessWeek Weekend. Check your local TV listings or go to businessweekweekend.com

CUTTING THE CABLES

Kodak and Nikon have outfitted consumer cameras with Wi-Fi so that you can wirelessly speed pictures to your computer or printer and sometimes more.

MODEL	Kodak EasyShare One	Nikon Coolpix P1
PRICE	$508 to $647	$428 to $550
THE GOOD, THE BAD, THE BOTTOM LINE	Designed to link wirelessly to kodakgallery.com, this big-screen shooter also can be used as a pass-around photo album. Resolution is limited to 4 megapixels, though.	This 8-megapixel camera with built-in Wi-Fi mates best with home networks but can't hook up to the Internet. A 5-megapixel version is $100 less.

Data: BusinessWeek, CNET.com

Philips Electronics North America Corporation.

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sense and simplicity

WHICH PHOTO SITES ARE BEST?

Online photo sites can post your slide shows and print shots of you on the beach. But the quality varies. **By Burt Helm**

SHARING YOUR PHOTOS once meant gathering friends and family in the living room, pulling up the Da-Lite tripod screen, and enduring an endless progression of look-alike vacation pictures—accompanied by the *kerchunk* of the Carousel projector in the background. Today, more than likely, your vacation snapshots are stored somewhere on your home computer. The good ones might also be on an online service that lets you organize them, invite friends to browse through them, e-mail them as slide shows, and order them as prints, puzzles, and mugs.

To figure out which photo sites are the best, I test-drove a half-dozen of them, using a set of photos I had sitting on my hard drive. Generally, they're more alike than different: You upload your pictures over an Internet connection, and the sites give you the storage space and tools you need to organize and share them. Most of the sites also can accept your pictures by e-mail, handy if you use the camer bu into your cell phone.

If you're mainly interested in w your friends see when they visit o dotPhoto and Yahoo!'s Flickr ha most advanced sharing features. y care chiefly about the quality of prin order, Snapfish (now owned by He Packard) came out on top. For the si to use, try Shutterfly, which ca walks you through projects such a ing out a hardcover album or des photo greeting cards. I also loo Eastman Kodak's EasyShare G (formerly Ofoto) and Walmart.co Photo Center.

I'll start with prints, which are w draws most people to the online h sites. I uploaded the same batch of p to all the sites and enlisted a cou pros from BusinessWeek Online's a partment to help me evaluate the decided the Snapfish prints ha sharpest definition and amon brightest colors, but Kodak and do were close behind. The worst? Shu whose prints were blurry and dark

Fast Prints

PRICES FOR INDIVIDUAL prints s 12¢ at Snapfish and Walmart.co range as high as 29¢ at Shutterf same as the 29¢ you'd pay at the Rite-Aid if you took your camera for instant photos. (You can get c

ONLINE **PHOTO SERVICES:** A CLOSE-U

Which service you should choose depends on what aspect—from image s to ease of sharing—you're focused on.

SERVICE	Dotphoto dotphoto.com	Flickr flickr.com	Kodak EasyShare Gallery kodakgallery.com
COST*	19¢	N/A	15¢
COMMENTS	Design your own slide show, with music or voice narration. It's a nice alternative to generic templates on other sites, but with few custom options the shows can feel like PowerPoint presentations. The founder says more features, including the ability to upload your own .mp3s, are on the way.	Sharing's the house specialty on Yahoo's photo site, which lets you share full-resolution snapshots with friends, or load them onto a photo-blog for all the world to see. Surfing strangers' artsy photo-blogs can become addictive, too. The drawback: You have to go elsewhere to order prints.	Slide show images are bigger than on of the other sites, and the editing softw lets users add nearly a dozen special p effects such as "cartoon" and "charco But the site formerly known as Ofoto c be cumbersome, and navigation requi too much clicking.

SERVICE	Shutterfly shutterfly.com	Snapfish snapfish.com	Wal-Mart Photo Center walmart.com, click on "photo cente
COST*	29¢, 19¢ for prepaid bulk orders	12¢ mail order, 19¢ for express service	12¢ mail order, 19¢ for express service
COMMENTS	It's one of the easiest to use, and walks you through a lot of fun extras such as designing a hardcover album. Prints are pricey, however, and looked blurrier and darker than those from most other sites.	The Hewlett-Packard-owned site doesn't have many features for advanced users, but it's fine for most digital shutterbugs. The print quality is high, and prices are low.	Upload your photos, click the "order" button, and fresh prints will be ready a local Wal-Mart in an hour. Look elsewh for online sharing, however—slide sho images are tiny.

*Per 4X6 print

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ps Flat TV with Ambilight. It only makes sense to get the most out of your sion, so you'll never want to turn off the world's first and only Ambilight feature. alyzing the incoming TV signals, the Ambilight system projects a background color your room and your eyes with the dominant color on your TV screen. High-Definition Flat TV with Ambilight from Philips – the next step in the evolution evision.

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rates at Shutterfly if you prepay for photos in bulk.) Usually, you get your prints in the mail in two or three business days. With some services, you can speed up the process by picking up your prints at a local drugstore: Kodak will do next-day in-store printing at any CVS. For 19¢ apiece, Walmart.com will print your uploaded photos at a Wal-Mart within an hour, and Snapfish will do the same at Walgreens.

There are lots of options beyond 4x6 glossies. You can order your favorites professionally framed, on greeting cards and calendars, or printed as hard- or soft-cover photo books. I found Shutterfly the best for such projects. For holiday cards, for example, Shutterfly lets you pick different photos for different recipients and even add personalized messages in a variety of fonts. When you're finished, Shutterfly mails off the custom cards individually (and it lets you choose which U.S. postage stamp to use).

You can slap your photos on dozens of tchotchkes, too. Beyond the usual shopping-mall offering of photo calendars, mugs, and mousepads, a few of the sites offer some oddball products: Snapfish, for instance, will sell you boxer shorts or a dog leash decorated with the image of your choice, and dotPhoto will turn your album into a collection of edible chocolate business cards. The cards aren't cheap: 16 will run you $40.

If you need to edit your photos before you print them—beyond simple cropping—I concluded that you're better off doing it on your computer before you upload them. Even the basic photo-editing software that comes with most digital cameras will do a better job than the editing tools on these sites. Take red-eye correction: Wal-Mart's and dotPhoto's tools didn't seem to do anything, but Kodak's left a photo of my brother looking like a zombie, with big gray voids where his pupils once were.

Theme Music

EACH SITE WILL ALSO let you drop a digital album into a ready-made slide show template and send it out by e-mail. The end result was pretty similar at Snapfish, Shutterfly, and Kodak. Wal-Mart's slide shows, however, limit the image size to a measly 2.25 in. by 3.25 in., compared with 5 in. by 7 in. at Kodak, and 4 in. by 6 in. with most others. The Wal-Mart size is just too small to see on a computer monitor.

Both dotPhoto and Flickr take a more ambitious approach to sharing. With dotPhoto's Show Builder tool, you can drag and drop photos into a specific order; add captions, titles, and a special background; and top it all off with theme music or a voice recording of your own narration. It's pretty slick to put together and looks better than slide shows from the other sites. (For one thing, every page is not emblazoned with the company's logo.) But the backgrounds are corny, and the music, which has names like "sly robot" and "diva feva," is synthesized and repetitive. [illegible] ly, as of [illegible] dotPhoto [illegible] you to [illegible] your own [illegible] files to accompany the show.

FIDO I.D. Snapfish offers a dog leash that holds shots of your best friend

Flickr is the only site of the s[illegible] doesn't sell prints; its appeal lies s[illegible] sharing. You can post snapshots a[illegible] ate your own photoblog with full-[illegible] tion photos open for public-viewi[illegible] tiquing, and downloading. You c[illegible] your photos with keywords, su[illegible] "wedding" or "New York," so they [illegible] up with similar photos in searches [illegible] entire Flickr site. Flickr's user com[illegible] ty leans toward the artsy side, so m[illegible] the photos are offbeat, unexpecte[illegible] even strikingly beautiful. It's poss[illegible] sit for hours just clicking through [illegible] dreds of them.

Here's what I didn't like about [illegible] the sites:

» You can't blow up the pictures to [illegible] them easier to see while you're lo[illegible] at them on your computer monito[illegible] only exception is Flickr. The dot[illegible] site lets you go to a full-screen vi[illegible] its slide shows, but that just mak[illegible] same low-resolution image [illegible] and blurrier.

» In most cases, you pretty [illegible] have to use Microsoft's In[illegible] Explorer to take advanta[illegible] even basic features of th[illegible] sites, a problem for folks [illegible] own Macs or depend on such [illegible] browsers as Mozilla Firefox or Oper[illegible] loading photos is far more tedious [illegible] other browsers, and basic editing [illegible] mands such as cropping or rotatin[illegible] ages sometimes don't work at all.

» In most cases, visitors must be [illegible] members even to see [illegible] pictures. Kudos to [illegible] Photo and Wal-Ma[illegible] sending them straig[illegible] your slide show or all[illegible] The others make you [illegible] tees sign in, sign u[illegible] navigate through pag[illegible] offers before they g[illegible] your snapshots. Ya[illegible] Flickr is by far the wor[illegible]

Despite the quibbles, these o[illegible] photo sites still are the quickest [illegible] cheapest way to get your photos o[illegible] your personal hard drive and int[illegible] minds and [illegible] of a wider [illegible] ence. They [illegible] beat doin[illegible] the old-fashi[illegible] way. ■

FAMILY PUZZLE Also available: chocolate business cards with your face on top

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ake every stroke count.

ips Norelco SmartTouch-XL. Three does more than one. In rowing.
in shaving. The SmartTouch XL has three shaving rings in each of the three shaving
ds, not one. So it's designed to shave more with every stroke. And it actually
ts to stay on your face and neck, catching even tricky hairs. Make your mornings
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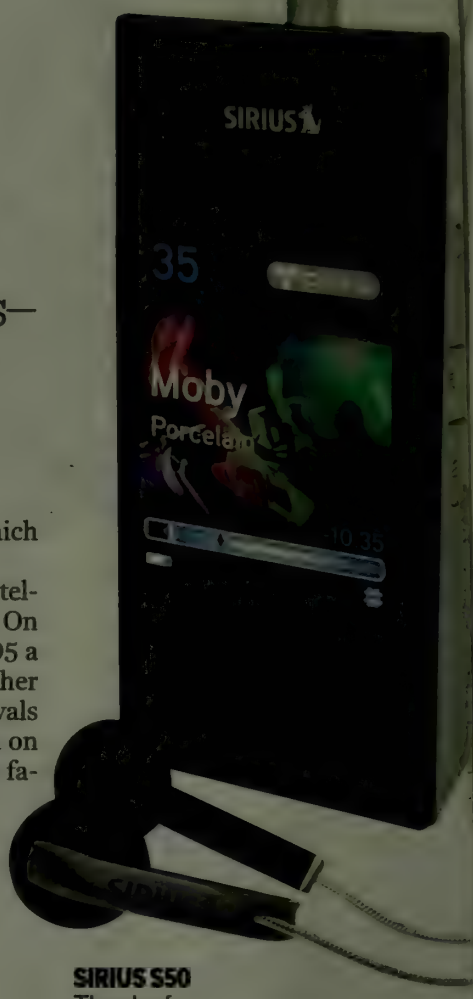
ALL BRUCE, ALL THE TIME

With satellite radio, you get vast choices—and cool devices. **By Adam Aston**



SIRIUS S50
Thanks for all the memory

WHAT EXPLAINS the rapid growth of satellite radio? Barely four years after the first signals bleeped down from orbit, some 8 million subscribers have signed up with Sirius Satellite Radio and XM Satellite Radio, the twin stars of digital broadcasting. That's a faster adoption rate than any prior major new consumer technology—from VCRs to MP3 players—over a similar period.

The increasing availability of satellite-ready radios in most new vehicles has sped up the rush. Plus, as the units have shrunk in size and price, they've escaped from the car. Although they're still works in progress, even handheld versions—such as the XM2go line and the recently-launched Sirius S50—are hitting store shelves.

These handhelds make satellite radio more accessible and give you greater opportunity to listen to it. When a favorite song comes on, you can hit a button and the radio will record the full track. The $300 XM2go portable, introduced last spring, stores up to five hours of audio. The newer Sirius S50, at $360, receives satellite signals only while docked, but it can hold up to 50 hours of audio which you can play back any time.

Of course, the real attraction of satellite is the programming, not the gear. On that front, XM and Sirius (both $12.95 a month) continue to one-up each other and to do what their earth-bound rivals can't. Recently, the two have focused on locking up pro sports leagues and famous on-air personalities. In the past year, Sirius has signed up Martha Stewart and, most famously, shock jock Howard Stern. XM countered with Ellen DeGeneres and Tyra Banks, among others.

Niche Interests

IN THE COMING YEAR the rivalry is likely to shift to niche interests such as artists with fanatical followings, says Craig Moffet, an analyst at Sanford C. Bernstein & Co. Already fans of Frank can enjoy a Sinatra-infused channel on XM. At Sirius, Parrotheads can tune into Jimmy Buffett-themed Margaritaville programming 24 hours a day. Bruce Springsteen's E Street Radio starts a three-month gig on Nov. 1.

Services are multiplying for motorists, too. XM was first to deliver real-time data to in-dashboard GPS ap ping. By merging tff and weather with ba maps, these systems let drivers see or gestion in advance and steer clear of m Sirius is not only following with si il data services but also aims to be firs ou with "video to the backseat" in 2006 Fo an as-yet undisclosed premium, the er ice promises to pipe cartoons and m si videos to rear-seat displays. Mom m Dad, meanwhile, can keep tapping a n to Jimmy Buffett in the front. ■

LIMITED-EDITION BOXES

The iPod's minimalist design has inspired sleek audio complements. For the iPod's design-conscious fans, Tivoli Audio has spiced up its classic Portable Audio Laboratory (PAL), a battery-powered AM/FM radio. Thanks to its surprisingly big sound—and a standard input jack—the PAL has become a favorite iPod mate.

Now, with an eye to winning over collectors, Tivoli has rolled out the PAL 2005 Fashion Collection, which comes in four custom shades that will be switched yearly—in sync with runway trends—and then permanently retired. Of course, an iPod isn't necessary to enjoy the $150 PAL's clean look and sound. But it com in an iPod-white version, too, just in case.

—Adam Ast

My client just added 1 BR and .5 BA.
No problem–I'll bring this job home on time.

So why is it so hard to get
my own Web site built?

First Floor Plan

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THE CALL OF THE WEB PHONE

Despite a few lingering glitches, voice over the Internet means cheaper service. And customers love it. **By Olga Kharif**

JUST A FEW YEARS AGO, using the Internet to make cheap phone calls was better in theory than in practice. Connections were often crackly and had echoes, and households that traded landlines for the Internet could find themselves unable to call 911 or without service in a power outage.

Those problems haven't totally been solved, but the providers of Voice over Internet Protocol (VoIP) are trying to make their service indistinguishable from landlines. Consumers are responding enthusiastically, with 3.25 million estimated to be buying VoIP phone services by the end of the year, says researcher Yankee Group—nearly three times as many as in December, 2004.

Certainly, you have plenty of choices (table). Monthly rates run from as little as $19.95 at Lingo and Packet8 to as much as $54.95 for Comcast Digital Voice for unlimited local and long-distance calls. (With most VoIP services, international calls are actually more expensive than using a calling card.) There are also activation, shipping, and modem-lease fees. Still, for a household spending an average of $53 a month on traditional local and long-distance calling, VoIP can translate into more than $300 in savings a year.

With most VoIP services, you have to install phone adapters—modem-like boxes acting as intermediaries between a phone device and your broadband connection—on your own or with a bit of over-the-phone tech support. With Comcast Digital Voice, you get a service call with professional installation. With AT&T CallVantage, it's a $140 option.

The beauty of VoIP is that it will generally work with your standard wired and cordless phones. Of course, you can splurge on new video-calling gear. The Motorola Ojo PVP-1000, for example, sports a striking futuristic design and is a great way for family members to stay in touch—provided, that everyone in the family has one.

VoIP has lots of other cool features. Because they are Web-based services, Vonage and AT&T CallVantage can notify you of new voice messages and mail and send along an audio attachment. VoIP services can also usually provide you with a phone number in an area code outside of your city, state, or even country of residence. You could get a New York VoIP number so your college kids in the city can ring you up free of charge—even though you happen to live in Florida. VoIP service providers may be able to use your existing phone number so you don't have to call all the people you know to have them update your address book entry.

Before you join the VoIP revolution, bear in mind that most services falls short of traditional phone service in several ways. Skype Technologies, the world's most popular VoIP calling service, mainly facilitates free calls between computers so your phone won't receive the calls when your PC is shut down unless you forward them to a regular phone for a small fee. Since VoIP operates through your broadband connection, any disruption will cut off your phone, too.

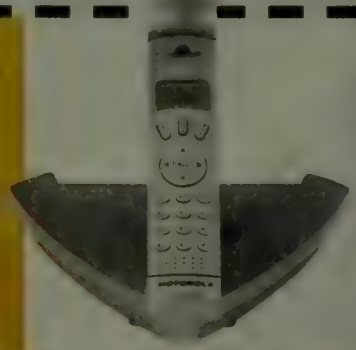
Doubling Up

MANY CUSTOMERS choose to retain the traditional landline for local calls and use VoIP for long distance. After all, if your neighborhood loses power, most VoIP services will go dead as well—not true with traditional phone service, which is supported by back-up batteries. One of the notable exceptions to this rule is VoIP service offered by cable companies like Comcast. Comcast provides a back-up battery that keeps your phone functioning for up to eight hours during power outages.

Some other VoIP services can't pick up 911 call through at all. Or, if you have a VoIP phone number with a different area code from your place of residence, the call might be dispatched to the wrong location (say, to a New York emergency center rather than to Florida, where you live). That's a big problem, considering that the number of residential 911 calls placed through VoIP will rise from 370,000 in 2004 to 3.5 million in 2006.

COOL TOOLS

Internet telephony gives you the ability to make video calls. Here is some of the gear that can help you do it.



MOTOROLA OJO PVP-1000
$450
motorola.com
With its Space Age look and video compression technology, Internet telephony never looked so good, but you'll need two to talk to a friend or loved one.

LOGITECH QUICKCAM FUSION
$99
logitech.com
A 1.3 megapixel camera. QuickCam includes software to track facial movements and cool technology for digital avatars and other video effects.

AN EXPANDING MENU FOR INTERNET CALLING

Operators are standing by to sign you up—or you can do it online

SERVICE	AOL TotalTalk	AT&T CallVantage	Comcast Digital Voice	Lingo
CONTACT	877 AOL-SPEAK, totaltalk.com	866 816-3815, www.usa.att.com/callvantage/	888 824-8264, comcast.com/digitalvoice	866 546-4603, lingo.com
COST*/ COOL FEATURES	$29.99 per month, with the first month currently offered free of charge If you are online, it will tell you who is calling. Another feature allows you to check your e-mail via phone and to respond to it by voice.	$29.99 per month, first month free if you sign up online Allows you to set up conference calls with as many as 10 participants. You can also record a message and send it to several people at the same time.	$54.95 a month; $44.95 a month if you already have Comcast cable or Internet service Dial 0 and an operator will patch you through to a number that's busy. Screening feature allows you to program your phone not to accept calls from certain callers.	$19.95 per month, first month free Besides unlimited long-distance calls in the U.S. and Canada, the service offers unlimited calling to 17 countries in Europe. Anonymous Call Rejection feature allows you to screen out calls that don't have a caller ID.
SERVICE	Packet8	Skype	Verizon VoiceWing	Vonage
CONTACT	866 TRY-VOIP, packet8.net	skype.com	800 270-5369, verizon.com/voicewing	866 243- 4357, vonage.com
COST*/ COOL FEATURES	$19.95 per month** If you have several phone numbers going to a single phone, you can choose different ring tones for the various lines. Offers a $99 videophone that works only with Packet8 service. Press the "still" button on your videophone to get a snapshot of what's on your screen.	Free calls to and from other Skype users. Otherwise $36 (approximately) per year allows phone users to reach you. There's also a per-minute charge for calling outside the Skype network. You can get an international phone number in seven countries.	$29.95 a month for the first 12 months if you use a Verizon broadband service, or $34.95 with any other broadband providers. Enhanced call-forwarding will allow you to have your calls forwarded for a specific date and time, or on a regular basis.	$24.99 a month Click-2-Call allows users to click on a phone number written anywhere in their computer, and the Vonage phone will dial it. Calls between Vonage customers anywhere in the world are free.

*Cost of an unlimited local and long-distance calling plan. Additional activation, shipping, modem lease fees, and other charges are not included and may apply. **For unlimited video calling plan, need to sign a two-year contract

According to Intrado, which provides 911 services to public safety groups and telecom companies.

U.S. telecom regulators have taken these concerns to heart. The Federal Communications Commission has set a Nov. 28 deadline mandating that all service providers aiming to displace traditional phone service give emergency-response workers the names and locations of their subscribers. This rule does not apply to outfits, like Skype, offering mostly PC-to-PC calling.

You might also run into problems if you have a home security system. VoIP may not work with your alarm set-up, so you might ask your security company to tune your system or even install a cellular back-up system. That could run up charges of $200 for the installation and $10 extra in monthly payments.

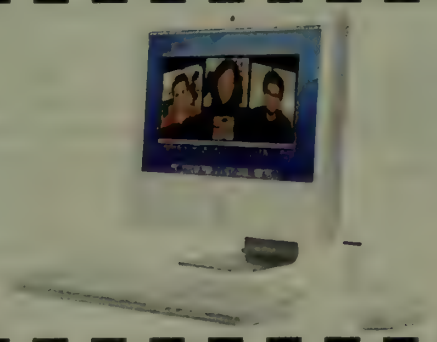
Clearly, VoIP is a young technology, with lots of technical and regulatory knots still to be worked out. But it has a lot to offer: increasingly crisp call quality at a low price, with features traditional phone service providers often lack. Since most providers let you sign up without locking yourself into a one- or two-year contract, VoIP may be worth a try. ■

PACKET8 VIDEOPHONE

$99 with Packet8 Plan

packet8.net

Video chat with friends and family who are also Packet8 customers. You can also plug your camcorder or camera into the device to show video and photos of your latest trip.



APPLE IMAC WITH ICHAT AV

Free with Mac OS X Tiger

apple.com

Ring up a buddy or relative with this Mac-only software that makes multiperson video and audio confabs a snap over a Web connection.

HIGH TECH FOR THE ROAD

Your car lacks the right stuff? Buy the gizmos separately. **By Olga Kharif**

MOST LUXURY CARS NOWADAYS COME WITH PLENTY of bells and whistles, such as hands-free calling for your cell phone and GPS navigation systems. But if your car doesn't have the exact option you need or want, don't worry. You can get most of these gizmos from chain retailers, and the aftermarket versions often leave their factory-installed cousins in the dust. Better yet, most of these systems work on any car, cost less than you think, and often don't require complicated or expensive installation. They can go a long way to make you more comfortable and maybe even safe.

DIRECTED ELECTRONICS TWO-WAY RESPONDER SECURITY SYSTEMS REMOTE

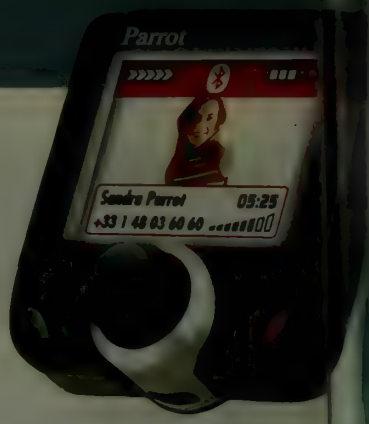
$419 for security systems that include the two-way remote at authorized retailers, listed at viper.com

These security systems don't just beep an alarm when a vandal is trying to get into your car—they tell you about it. The remote control, which also serves as a key fob, has a tiny liquid-crystal display that shows you what's going on whenever your car alarm goes off. You need to be within a quarter of a mile from your car for the paging function to work. You can use the remote to turn the alarm off, or to lock or unlock the doors. The remote comes with Viper, Clifford, Matrix, and Python brands of security systems.

GARMIN STREETPILOT I5 GPS NAVIGATION SYSTEM

$499 at Wal-Mart, Best Buy, and Circuit City

This baseball-size global positioning system comes preloaded with the latest maps of North America and can give you turn-by-turn directions to where you need to go. It attaches to your windshield with a suction cup and operates on AA batteries or an adapter that plugs into your cigarette lighter. It comes with more than 6 million points of interest, such as gas stations, ATMs, and restaurants, and you can load your own customized points by plugging the GPS unit into your computer.



PARROT CK3200 LS-COLOR BLUETOOTH CAR KIT

About $250 at Amazon.com, Fry's, and PCMall.com

Parrot's newest hands-free car phone kit, which will appear early next year, is installed in your dashboard to work with Bluetooth-enabled cell phones. The color LCD shows the caller ID of incoming or outgoing calls, and the system automatically mutes the car's radio or CD player and pipes the call through the speakers. Voice recognition lets you make calls from a 150-name address book just by saying, for example, "Call John."

DAVIS INSTRUMENTS CARCHIP E/X WITH ALARM MODEL 8225

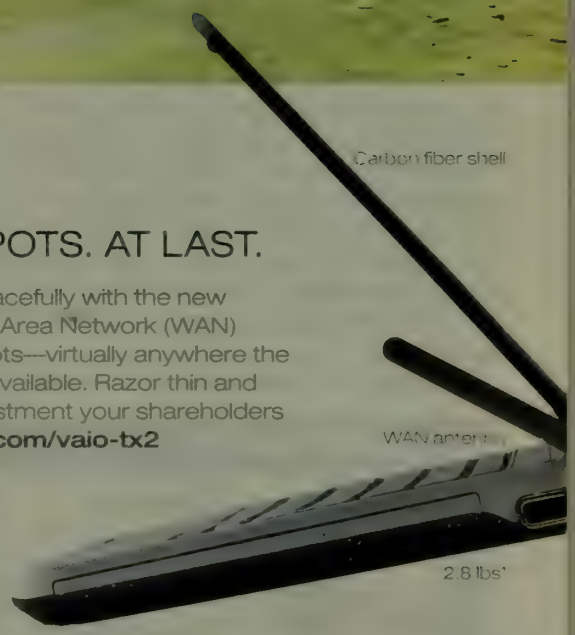
$199 at Sears and specialty retailers

Wonder why the "check engine" light is on? The CarChip E/X, which typically plugs into a connector by the steering wheel, is designed to retrieve engine diagnostic trouble codes from your car's computer. They can help you decide whether you need to see a mechanic, or merely tighten the gas cap. In addition, it can store up to 300 hours of driving data, such as the time and date of each trip, its distance, and your speed. In the event of an accident, it will generate a log showing your speed and braking in the 20 seconds before the impact, handy if your fender bender ends up in court.

SONY

SHAREHOLDERS MANAGED.
VACATION SALVAGED.

Sony recommends Windows® XP Professional.



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'Mosh Pits' Of Creativity

Innovation labs are sparking teamwork–and breakthrough products

THE RAZR, MOTOROLA'S half-inch-thick, ultralight cell phone, broke a few rules in the industry when it appeared late last year. It's impossibly compact, simple to operate, and elegant, with an artfully hidden antenna and impressive photographic capabilities. The phone marked a sleek detour from the drive toward bulky features, such as powerful storage devices and high-power cameras, that were fattening up phones and preoccupying rival cell-phone makers. No wonder the Razr has sold a breathtaking 12.5 million units in less than a year.

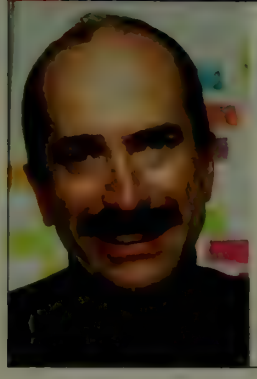
But Motorola also had to break some internal rules to get the Razr to market. The biggest: Much of the critical work on the phone was done at a downtown Chicago innovation lab known as Moto City—rather than solely in the company's sprawling traditional research and development facility in suburban Libertyville, Ill. Decorated in a trendy palette of oranges and grays, Moto City fills the 26th floor of a high-rise once occupied by a dot-com.

To hustle the phone into production, Motorola engineers left their cubicles in Libertyville to team up with designers and marketers 50 miles to the southeast in Moto City. With its open spaces and waist-high cubicles for even senior managers, the lab fostered teamwork and a breaking down of barriers—both of which contributed to the success of the project. Razr developers, for instance, bypassed a normal process of running new-product ideas past regional managers across the world. Because they wanted to lead the market, not just give managers and customers what they thought they wanted, the Razr team put aside normal practices. "We did not want to be distracted by the normal inputs we get," says Gary R. Weiss, senior director of mechanical engineering. "It would not have allowed us to be as innovative."

FASTER, FASTER

INNOVATION LABS are a key part of a movement to overhaul old-style R&D. They are designed to complement, and sometimes even replace, the intensive traditional system—which required that scientists or engineers toil away privately for years in the pursuit of patents, then hand their work over to product developers, who in turn dropped it onto designers and marketers' laps for eventual shipment to the public. The leisurely old hand approach worked fine a few decades ago when the likes of Bell Labs and RCA laboratories could take years to develop transistors and color TVs, knowing they would enjoy protected markets for years to come. But today's rapacious competition means innovations grow stale fast. Companies must churn out updates far more quickly

PLAYBOOK: BEST-PRACTICE IDEAS



How to **Build** a Successful Innovation Lab

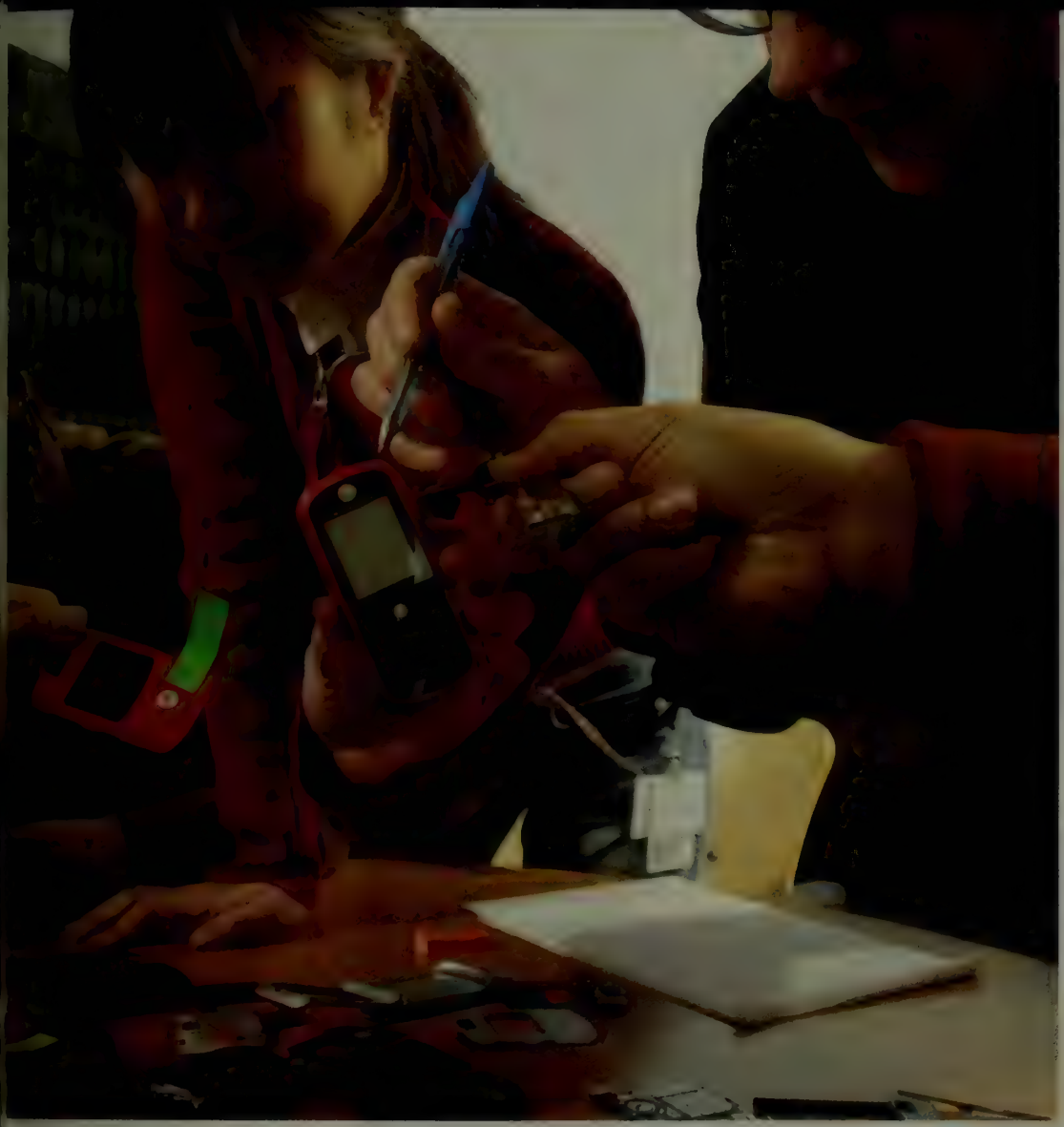
Tom Kelley, general manager of IDEO, shares his insights

ESTABLISH A HOME ROOM FOR IDEAS
The ideas should bounce around, but the location shouldn't. Commit a clearly marked, dedicated place for innovation, near where staffers work so that they visit frequently.

PLAY EXECUTIVE PICTIONARY
Allow lots of space for whiteboards and visuals. People need to sketch out ideas to communicate them well. Use walls; avoid delicate surfaces that can't take heavy use.

RISK FEELING FOOLISH
In brainstorming sessions, go for quantity and avoid being judgmental. Conformity is a creativity-killer. To keep some structure, number the ideas. A hundred ideas per hour—you're cooking.

STOCK UP AT STAPLES
To create the feeling that the lab is a place to thrive, stock it liberally with items such as prototyping kits, Post-its of all sizes, fat-tipped markers, and X-Acto knives.



MOTO CITY Motorola's innovation lab is in downtown Chicago

lready, Motorola has unleashed follow-on hones, such as the candy-bar style Slvr nd the rounded, pert-looking Pebl, along ith a bevy of novel colors, such as hot ink, for the flip-top Razr.

Certainly, the need for speed in innoation stretches beyond high-tech comanies. Outfits as varied as Mattel, Steelase, Boeing, Wrigley, Procter & Gamble, nd even the Mayo Clinic now use such abs to shatter bureaucratic barriers that ave grown up among inventors, engieers, researchers, designers, marketers, nd others. Such barriers, say today's anagement gurus, are an outdated egacy of Frederick Winslow Taylor, the ate-1800s industrial engineer who advoated breaking down tasks so that differnt departments could handle jobs successively, leading to the assembly line. Vhile well suited to the 20th century, the yle can only crimp innovators in the 21st entury, says Jack Tanis, director of aplied research at Steelcase. Now, "Tayrism is breaking down," he adds.

Instead of assembly line, think swarming beehive. Teams of people from different disciplines gather to focus on a problem. They brainstorm, tinker, and toy with different approaches—and generate answers that can be tested on customers and sped to the market. At times, it's true, innovation labs can seem like dot-com flashbacks, full of pretentious rhetoric, black-clad engineers, and interior design clichés like cappuccino machines and foosball tables. But the fact is that the concept has been embraced by companies far removed from Silicon Valley. These organizations have discovered that innovation labs can be a powerful tool for big corporations to cut through their own bureaucratic bloat.

Labs are also being used to smooth out production glitches

A central tenet of the innovation lab movement is that layout and design are crucial. Mattel Inc.'s preschool toy unit, Fisher-Price, has its center at company headquarters in East Aurora, N.Y., but it's clearly a separate part of the operation. Called the Cave, the center boasts bean-bag chairs, comfy couches, and adjustable lighting that makes people feel as if they're far from the office. Teams of staffers from engineering, marketing, and design meet there with child psychologists or other specialists to share ideas. After observing families at play in the field, they return to brainstorm—or "sketchstorm," as they call it. Then they build prototypes of toys from foam, cardboard, glue, and acrylic paint.

Mingling with people from various disciplines has been key at the three-year-old operation. Staffers such as Tina Zinter-Chahin, senior vice-president for research and development, call the interaction spelunking, since it's based on an idea of taking a "deep dive" into product development. "People at first were skeptical," says Zinter-Chahin, noting that toy designers didn't care to spend so much time with marketers. "They said: 'Come on, I'm going to go away for five days and take a marketing person?' We found that while they aren't great with foam and glue guns, they're great at hashing out an idea and positioning the product."

Already, Fisher-Price staffers can point to successes. After observing babies as they learned basic skills, the spelunkers realized that moms spent a lot of time teaching kids about such things in the house as doors, light switches, drawers, and kitchen utensils. While the company could boast about toys that make noise or flash lights, it was short on real-world practical stuff. It solved the problem with Laugh and Learn Learning Home, a $65 model home made of plastic, where kids can crawl through a front door and explore the alphabet, numbers, music, speech, and different sounds. A smash hit in its 2004 debut, it's now a full line of toys. The out-

fit has high hopes for a couple of forthcoming products, such as the Easy Clean high chair, the result of a spelunk about issues moms had feeding kids.

Although innovation labs are typically created to generate new product ideas, they are also sometimes used to improve manufacturing processes. At Boeing Co., for instance, nearly 3,000 engineers and finance and program management staffers from scattered locations in the Renton (Wash.) area were moved last year to the factory where 737 jetliners are assembled. "If you are in the office area, you can feel and hear the noises in the factory and can look out your window and see the wing tips going down that line," says Larry Loftis, director of manufacturing for the 737. "There is a constant reminder for the engineers."

Such shifts smooth the way toward faster working arrangements. To urge people to mingle, Boeing created common break areas where mechanics and engineers can talk shop over coffee or a snack, building informal relationships that could speed both daily working processes and innovations. Now, if a mechanic finds that a part doesn't fit, he can find an engineer to redesign it nearly on the spot. Or when a jet with a novel interior design first rolls on the line, the engineers and mechanics can make changes, as needed. "When things don't fit exactly right, they can change the engineering or blueprint in hours, instead of weeks or months," Loftis says.

Older workers may have a hard time giving up private offices

Such changes aren't always seamless. Older workers, especially baby boomers, may have a hard time giving up cherished perks such as private offices, say consultants at Steelcase who help design innovation lab workspaces—and sell companies the pricey furniture for them. Some workers define their success by counting ceiling tiles, measuring out the square footage they've got in their private space, and comparing it with that of others. By contrast, Generation Xers and others new to the workforce more often will trade privacy for amenities such as in-house recreational areas. Steelcase's design center, for instance, boasts a waist-high shuffleboard where staffers can unwind.

THE CAVE Fisher-Price's lab in East Aurora, N.Y.

For some companies, innovation labs are not places where all old ways are killed off once and for all. Instead, they let employees retreat from their normal workplaces to solve problems and then return reenergized. Procter & Gamble Co.'s Clay Street Project, named for its Cincinnati location, is a haven where teams of staffers from various disciplines go for stints of 6 to 10 weeks or so to wrestle with product problems. Free in such comfortable environments, they can look at challenges afresh. "They try to create transforming breakthroughs," says Roger L. Martin, dean of the Rotman School of Management at the University of Toronto and a P&G adviser.

Many innovation labs try to encou the sense, however illusory, that hier has been tossed out the window. Mot CEO Edward J. Zander, 58, comes b company's design center once a we more, both because it's close to his d town Chicago home and because he the informality and energy: Many phone designers are twentysomethin only slightly older. "The market for h sets today is young people, and we h lot of young people here," says Za saying the center is "like a mosh pit."

FAR FROM THE SUITS

INDEED, MOTOROLA broke another by locating its center far away fro "suits" in corporate headquarters, ting it downtown because the spot s staffers better. Designers can walk d the street or hop on the subway t their phones in use. And many of place's young workers shudder at the of working in Libertyvill grew up in the suburbs, a didn't want to go back," Michael Paradise, a 23-year industrial designer.

Consultants who ad companies on such innova labs are fond of lofts, w high ceilings create a sens openness. A lack of walls veys the idea that commun tion is free-flowing. And an sence of private offices sugg that teamwork is the hig priority. "We think everyth worth doing is done by gro not by individuals," says Kelley, general manager IDEO, a Palo Alto (Calif.) de consulting firm. He urges end to rigidly aligned cubi in favor of loose, ecle arrangements because all th cubicles marching ahead i line "sends a signal that yo got to be on your best beh ior." Instead, he says, pe need to feel free to be creative.

To be sure, innovation labs are panaceas. If the ideas that emerge f these facilities are flawed, the prod undoubtedly will be failures. And if m agers don't get behind winning but p ishable ideas quickly, the products co likewise be doomed. But for big com nies that are stuck in creative ruts, th labs can be places where something m ical gets started. ■

–By Joseph Weber in Chic with Stanley Holmes in Sea and Christopher Palmeri in Los Ang

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BUZZ BOOST *North Country*, starring Charlize Theron, is being plugged by activist groups

Lights, Action, and Bleeding Hearts

EBay billionaire Jeff Skoll is backing a flurry of movies with political messages

COMING SOON TO A THEater near you: Jeffrey Skoll. Or, more accurately, a star-studded film with backing from the billionaire who developed eBay Inc.'s business plan and was its first full-time employee. Skoll's company, Participant Productions, is off to a rousing start in its quest to promote social awareness on the big screen. Three of the highest-profile movies this fall have funding from the former eBay president: *Good Night, and Good Luck*, about Edward R. Murrow's battle with Senator Joseph McCarthy; *North Country*, starring Charlize Theron as a miner confronting sexual harassment (both films in theaters now); and *Syriana*, an oil espionage thriller starring George Clooney and Matt Damon due out Nov. 23.

Hollywood has a history of drawing in newly made millionaires anxious to buy access to the right parties with vanity projects. Some in the industry question if Skoll, worth some $3.5 billion, is any different. "I see guys come here and lose their fortunes all the time," says Brian Robinson, senior vice-president of worldwide marketing for Morgan Creek Productions.

But Skoll, who launched his firm with $100 million in early 2004, is not your usual rich dilettante (though the *Financial Times* did name him one of eight most eligible billionaire bachelors). The Montreal native moved from Silicon Valley to Beverly Hills last year to spend time questioning Hollywood players about why they don't make more movies with political messages. "The system's set up for safe bets: sequels, superheros, romantic comedies," he says. "All the people I met had a particular interest in doing something more meaningful. I thought if I could start a company that takes the risk out of doing these films, they'll get done."

One thing that sets Skoll's efforts apart is that each film has a social issues campaign. Just as he built an online com nity for eBay, he's trying to build around his movies. The firm part with nonprofits to launch Web aware campaigns that it hopes will nurtu network on its Web site, participate Users can start blogs—even submit a and video reports that may be picke by "partners" such as PBS and XM S lite Radio. Bloggers include people inspired films, such as journalist Sh Wershba, who was played by Pat Clarkson in *Good Night, and Good Lu*

BLOCKBUSTER, REDEFINED

THAT'S A SMART WAY to build netwo and it's smart business. The National ganization for Women and the Family olence Prevention Fund plug *N Country* front and center on their sites, urging members to support the and promoting sneak previews at 20 lege campuses across the country.

Skoll wants his venture to make m ey, but says that's so he can plow it more films: "For me, it's philanthro don't expect to see any money come b to me personally." He measures socia turns as well, so in theory, money-los films can be successful. Skoll plans to at things such as how much a film ra for nonprofit partners and how active cial networks on the Web sites becom

This is not Skoll's first foray "strategic philanthropy." He has gi $567 million to support social entre neurs. He started a program at Oxfo Saïd Business School to train nonpr leaders and funded a PBS minise about people making a difference in t communities. Next up on the big scre director Richard Linklater's film of book *Fast Food Nation*, a critical take the fast-food industry. Skoll hopes it beat out, say, *Superman Returns*. ■

–By Jessi Hempel in New Y

BIO BOX

Jeff Skoll

From pumping gas in Toronto to producing movies in Tinseltown

BORN Jan. 16, 1965

EDUCATION BS in electrical engineering, University of Toronto, 1987; MBA, Stanford Graduate School of Business, 1995.

FIRST CLAIM TO FAME Developed the business plan for eBay as the company's president.

FIRST JOB PAIN Pumping gas at a full-service station in Toronto while in high school. It was so cold at times that exposed skin would freeze if not slathered with petroleum jelly.

ODDEST HOBBY Amateur hypnotist

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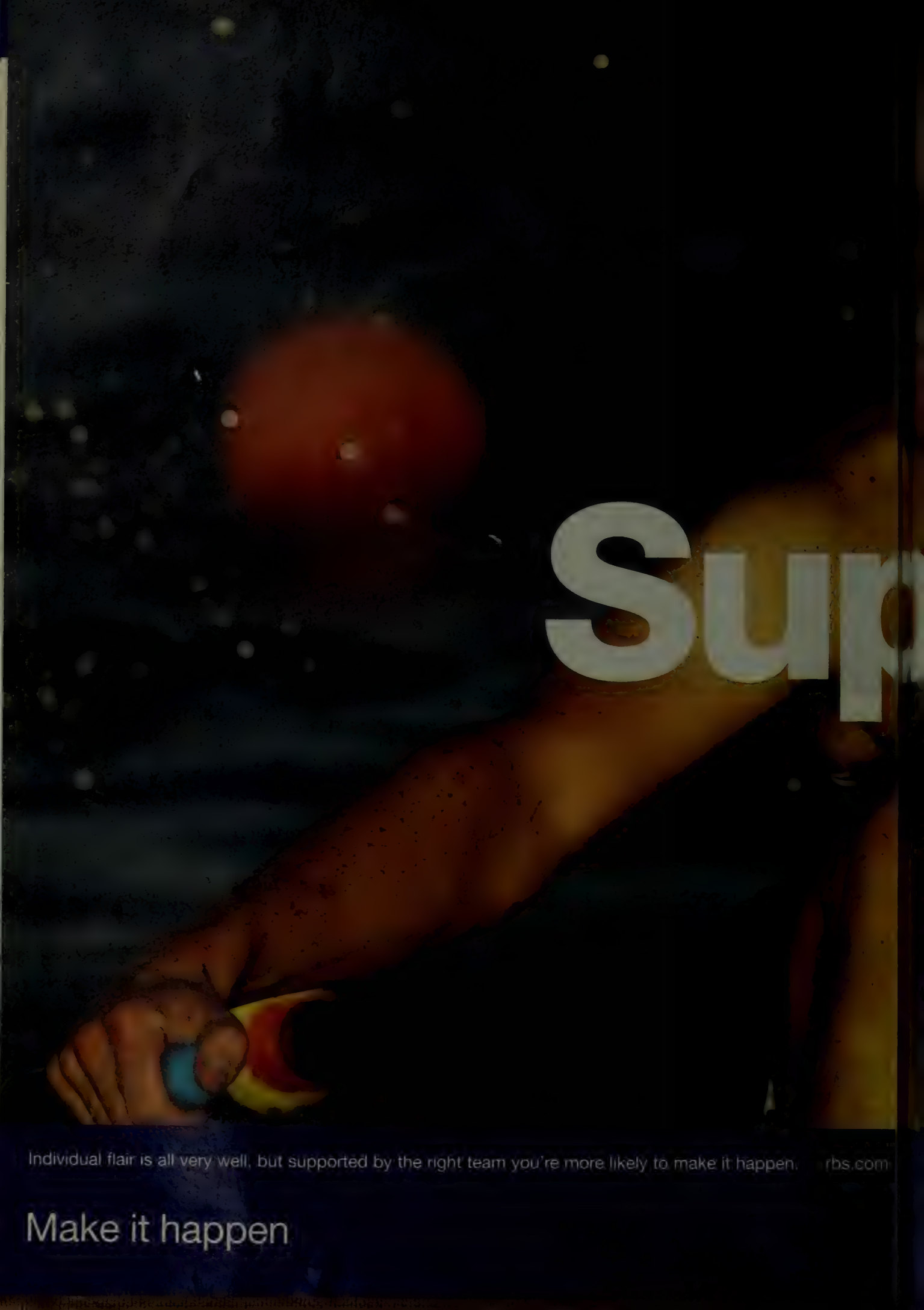
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A Break for The Defense

As doctors who validate tort claims come under scrutiny, business is on the offensive

In April, 2001, Alabama radiologist George H. Martindale got what seemed like an easy part-time job. An industrial testing company, N&M Inc. in Pascagoula, Miss., asked him to provide a second reading of X-rays of patients diagnosed with silicosis by another doctor who had conducted full medical exams. Over the course of about a year, Martindale—the father of four college-bound teenagers—read thousands of X-rays. At $35 a pop for just a few minutes work, the part-time gig brought in nearly $265,000 before he quit in June, 2002.

Last fall, Martindale discovered to his surprise that his cursory second opinions—done without the benefit of direct physical examinations or medical histories—had been used as clinical evidence by people making silicosis claims in a mass-tort lawsuit in Texas against more than 20 companies. Instead of supporting the alleged victims, Martindale backed off his reports. That drew the ire of Waco plaintiffs' lawyer Billy H. Davis Jr., who fired off a terse letter asking Martindale whether he could rely on reports the doctor had signed. Martindale shot back: "I learned that you had cited me as the diagnosing physician in certain silicosis cases. I told you that I personally had made no diagnoses," he wrote in a March letter obtained by *BusinessWeek*. "It was never my expectation that I would be identified as the 'diagnosing physician' in lawsuits." The letter also suggested that Davis had sought to prevent Martindale from speaking to the defense team, something Davis vehemently denies. "At no time did we ever attempt to influence Dr. Martindale's testimony," Davis says. Martindale declined comment.

Under questioning from defense lawyers, Martindale disavowed any diagnoses of silicosis for any of the alleged victims. His testimony was one of the key pieces of evidence that caused U.S. District Court Judge Janis Graham Jack of the Southern District of Texas to toss out many of the claims. "These diagnoses were manufactured for money," Jack thundered. She noted that of the 10,000 alleged silicosis victims in the lawsuit, 99% of them had been diagnosed by the same nine doctors. One doctor, she wrote, had his secretary fill out patient diagnoses on blank forms. Another analyzed 1,239 patients in 72 hours. And many of the silicosis victims had at one time been diagnosed with—and filed claims for—asbestosis. "These diagnoses were about litigation rather than health care," wrote Judge Jack.

Companies have been saying as much for years. Their gripe: that some plaintiffs' lawyers steer would-be clients in mass tort cases to unscrupulous or easily manipulated doctors who are predisposed to diagnose serious illnesses. Defense attorneys claim that medical screeners are paid more to deliver a positive diagnosis than a negative one. These questionable practices, defense attorneys charge, are used to validate injury claims in lawsuits involving everything from diet pills to welding material.

Some silicosis victims also filed claims for asbestosis

In the old days, business lawyers usually whined about these problems while writing checks to their courtroom adversaries. But now they're attacking oppo attorneys and doctors with unpreceder fury and tactical creativity. Expensive vestigations into the legitimacy of mec diagnoses, which led to the Jack opinio *In Re: Silica Products Liability Litiga* are just the beginning. Corporate c plaints about mass tort fraud have spu criminal convictions, ongoing crim

obes in three states, and an inquiry by the House Energy & Commerce Committee. The U.S. Chamber of Commerce has also begun building a database that will be used to identify relationships among screening companies, doctors, plaintiffs' law firms, and claimants, and keep an eye out for repeat plaintiffs. "We are at a turning point," says Lisa A. Rickard, president of the Chamber's Institute for Legal Reform. "The business model that the plaintiff bar has been using in mass torts is now coming into question and under scrutiny not only by judges but by prosecutors."

Plaintiffs' attorneys say the vast majority of mass tort claims are valid, with real victims and real illnesses brought on by corporate misconduct. They accuse business groups of exaggerating the importance of the misconduct uncovered so far to generate political momentum for protective legislation, such as a proposed asbestos bill that would limit lawsuits. "If you had 100,000 asbestos claims a year filed, there's going to be some small number of those claims that are fraudulent," says Frederick M. Baron, a partner with Baron & Budd in Dallas and a former president of the Association of Trial Lawyers of America. Baron says encouraging criminal and congressional probes is "another tactic of defendants who are trying to game the system."

Baron and others note that business has tried any number of novel tactics to undermine mass-tort cases throughout the years, with little luck. On Oct. 26 a judge dismissed a four-year-old civil racketeering case brought by G-1 Holdings Inc. against Baron & Budd and other asbestos plaintiffs' firms, ordering G-1 Holdings to pay the defendants' legal fees. And even in the wake of Judge Jack's highly publicized verbal lashing, not all judges are moved by defense lawyers' pleas to search for improper ties between plaintiffs' lawyers and medical experts. On Oct. 24, Judge Judith K. Fitzgerald of U.S. Bankruptcy Court in Wilmington, Del., turned down a request by WR Grace lawyers to send questionnaires to plaintiffs' attorneys but allowed the company to question claimants about connections between the lawyers and doctors who submitted diagnoses of asbestosis.

Nonetheless, business groups can feel the wind at their back. The Jack opinion has given cover to other judges who heretofore have been reluctant to question the veracity of thousands of possibly sick or dying plaintiffs. "Mass torts to an extent is mass politics. Judges don't want to take on the burden and accountability of getting rid of lots and lots of claims," says David M. Bernick, a partner at Kirkland & Ellis who is defending WR Grace and other corporations against asbestos claims. In federal court in Pittsburgh, Judge Joy Flowers Conti has indicated that she will allow USG to send questionnaires to 1,000 out of 150,000 asbestos plaintiffs to determine the reliability of their medical diagnoses. "Judge Jack ruled on an issue that is common to thousands of claims," Bernick says. "If you don't have reliable data, you don't have a claim."

The ramifications of the defense bar's new aggressiveness could be far-reaching. Lawyers representing about 80 defendants in federal asbestos litigation in Philadelphia used Jack's ruling to help persuade

Fighting **Back**

On many fronts, companies are attacking the sometimes-cozy relationship between plaintiffs' lawyers and doctors:

COURTROOM TACTICS
Defense lawyers are challenging diagnoses, subpoenaing doctors, and investigating business dealings between medical experts and plaintiffs' attorneys.

COMPUTER ANALYSIS
The U.S. Chamber of Commerce is building a database of mass tort claimants and medical screeners that will help identify plaintiffs that make multiple claims.

CONGRESSIONAL INQUIRY
The House Energy & Commerce Committee is investigating potential misconduct by doctors and medical screening companies in large lawsuits.

CRIMINAL CHARGES
More than a dozen people who filed fraudulent fen-phen claims are behind bars in Mississippi after being charged in an ongoing IRS-FBI investigation.

my deposition saying it should not take over an hour or so. I was soon contacted by you. You said you wanted to retain me as an expert witness before the deposition. I declined. During this conversation, I learned that you had cited me as the diagnosing physician in certain silicosis cases. I told you that I personally had made no diagnoses, that I had not examined any of the patients, and that I had only determined whether the readings were consistent with the disease previously diagnosed. Your response was "I certainly would hate to hear you say that at your deposition." I did so testify because it was the truth. I never "retracted" or "withdrew" my determinations; I just put them into a proper and accurate context.

> "I learned that you had cited me as the diagnosing physician in certain silicosis cases. I told you that I personally had made no diagnoses"
>
> *–Letter, George Martindale, M.D., to plaintiffs' attorney Billy H. Davis, dated Mar. 25, 2005*

federal Judge Charles R. Weiner to approve subpoenas for some 45 doctors and screening companies involved in diagnosing an estimated 150,000 to 200,000 asbestos plaintiffs. "We anticipate that the same thing that has happened in silica has gone on in asbestos for 10 or 15 years—the same doctors, the same screening companies, some of the same lawyers creating diagnoses where none existed," says Walter G. Watkins Jr., a partner at Forman Perry Watkins Krutz & Tardy LLP in Jackson, Miss., whose firm helped expose diagnostic errors in the silica cases.

Lincoln Electric Holdings Inc. in Cleveland and other companies fighting claims against the makers of welding materials also are taking aim. In a case involving about 1,100 plaintiffs in U.S. District Court in Cleveland, defense attorneys are using questionnaires to root out suspicious claims. They say some 40% of plaintiffs claiming neurological damage as a result of inhaling welding fumes have been plaintiffs in silica or asbestos cases. A single physician has diagnosed a majority of the claims, says John Beisner, a partner at O'Melveny & Myers and lead counsel for the defense group. "It's possible the plaintiffs could have been exposed to both asbestos and welding materials," Beisner says, "but it's more likely that they're in the Rolodex of plaintiffs' counsel." Richard F. Scruggs, co-lead national counsel for plaintiffs in the federal welding cases, says it's not surprising that welders would be diagnosed with asbestosis; many of them worked in shipyards and other industrial environments. He notes that defense teams, like plaintiffs' attorneys, make repeat use of the same doctors. And he predicts Beisner won't get far with the silica connection because it is the silicosis cases—not the welding cases—that are dubious.

Cases such as these have attracted the attention of Representative Joe Barton (R-Tex.), chairman of the House Energy & Commerce Committee, and Oversight & Investigations Subcommittee Chairman Ed Whitfield (R-Ky.), who in August opened an investigation into medical screeners and doctors in mass tort cases. The lawmakers are looking at whether medical experts are ducking ethical obligations by giving allegiance to the law firms who hire them rather than the patients they examine. Mass tort medical experts often claim status as consultants, thereby avoiding a doctor-patient relationship that would oblige them to meet a higher standard of medical care, including finding treatments and follo-u with sick patients. The congres inquiry will include a review of ta medical licensing boards to te mine if more oversight of scre is needed.

Meanwhile, the FBI and IRS a been prosecuting people accus making fraudulent claims against V based in Madison, N.J. The com made Pondimin and Redux, drug were taken as part of the fen-phe combination. Wyeth reached a $40 lion settlement in 1997 with dieters claimed to have developed leaky valves as a result of taking the dru that case, law firms trolling for clien up roaming echocardiogram screen known to defense attorneys as echo-ill in airport meeting rooms and hote rooms where they could attract thous of would-be plaintiffs.

The fen-phen trust had expected 36,000 claims; more than 87,000 p in. A 2003 audit by Wyeth turned up spread fraud, uncovering a numb echocardiograms that appeared to been tampered with. The U.S. Atto Office for the Southern District of M sippi in the past year has won more t dozen convictions in the case. A those sentenced: a former paraleg Schwartz & Associates, a Jackson law firm representing fen-phen plai

Now federal investigators in Phi phia are looking at whether lawyers tors, and medical technicians cons to submit bogus claims. "When a co ny is faced with one of these massiv gation situations, no matter how atte you are, . . . it's extraordinarily difficu any company to protect itself," says glas A. Dworkin, deputy general co at Wyeth.

In hopes making fraud easier t tect in the fu the Institute Legal Refor begun tracking repeat plaintiffs in tort cases. The Beta Project is comp information on asbestos claimants first step toward building a massive base of tort claims that will track not plaintiffs but their screeners, doctors law firms. Such a tool could be an mous boost to defense attorneys atte ing to identify bogus claims. "The would be to try to get evidence gene by these folks to be declared inadm ble," says Chamber Vice-President Policy and Research Linda Kelly. ■

–By Lorraine Woellert in Washi

DELIVERING PLAINTIFFS
Some firms use mobile screeners to find clients

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Rewired and Ready For Combat

SBC and Verizon are spending billions to stay competitive in the broadband era

ON A CRISP SEPTEMBER afternoon, Edward E. Whitacre Jr. bursts into a conference room on the 13th floor of the Ritz Carlton Hotel in Chicago. The CEO of SBC Communications Inc. is taking a break from a meeting with his board of directors, and he's in an upbeat mood. The 6-foot, 4-inch exec is a big football fan, and his alma mater, Texas Tech, is undefeated. "Undefeated!" he says. "Although I don't think we can keep winning 80 to nothing." (The final tally against Sam Houston State had actually been 80-21.)

When the conversation turns to the state of the telecom industry, his mood darkens. Cable companies and Internet upstarts are swiping millions of customers from SBC and other old-line phone companies. Just a few days earlier online auctioneer eBay Inc. had agreed to pay $2.6 billion for Skype Technologies, a Luxembourg startup that lets people make free phone calls over the Net. Pressed on the threat from these Web upstarts, Whitacre leans forward in his chair and raises his voice. "They don't have any fiber out there. They don't have any wires. They don't have anything," he argues. "They use my lines for free—and that's bull. For a Google or a Yahoo! or a Vonage or anybody to expect to use these pipes for free is nuts!"

A little defensive? Well, sure. Over the past 10 years, SBC and Verizon Communications Inc. have spent tens of billions of dollars building telecom empires so they could dominate the industry. Thanks to their string of megadeals, SBC and Verizon have become far and away the largest telecom players in the land, together controlling nearly two-thirds of all residential phone lines in the U.S.

But now a flock of rivals, including Skype, is threatening to wipe out the value of all those phone lines. They're using Internet technology to offer comparable calling services at half the price, without owning a single foot of telephone wire. In a recent report, analyst Anthony Noto of Goldman Sachs & Co. titled one section on the prospects for phone companies "The roadmap to the destruction of value." He wrote that they could lose 40% of their land-line residential customers over the next 10 years. Verizon's stock is down 21% for the year, to $30, while SBC shares have slipped 3%, to about $24.

So what are SBC and Verizon doing about all this? The companies' chief executives don't deny the seriousness of the threat. They may quibble with the pace of the decline, but neither doubts that their traditional phone businesses are history. So they're busy overhauling their operations to prepare for the new era. Both say that their futures depend on how well they perform in broadband, wireless, video, and corporate services. "We're not sitting back and waiting for the world to kill us," says Ivan G. Seidenberg, Verizon's chairman and CEO. "Before we get suicidal, we need to apply some adult thinking to this. It's not the death of anything. It just forces us to change faster."

The changes are already under way. As early as Oct. 28 the Justice Dept. and the Federal Communications Commission are expected to give SBC the green light to acquire AT&T and Verizon approval to buy MCI. The agencies may require several concessions, including the divestiture of some assets. The purchases will make SBC and Verizon much more important providers of communication services to corporations since AT&T and MCI are the largest players in that market.

Essentially, Verizon and SBC are trying to pull off a tricky balancing act. They need to boost revenues from the new services faster than their old businesses fade away. So far that has worked out fine. Wireless and broadband services have been more than enough to replace the decline in traditional voice. But the side of voice is expected to accelerate in the years ahead, and the wireless business is growing more challenging.

Cable companies, which have been offering local phone service over their fiber lines, haven't been able to sell wireless service because they don't own such networks. But on Oct. 24, Comcast for

AARON PILAND

nfirmed that it's negotiating with Sprint extel Corp. to use Sprint's network to sell ireless service. Time Warner Inc. and Cox ommunications Inc. are expected to rike similar deals with Sprint. Even Net mpanies such as Vonage Holdings orp. are gearing up for wireless offerings their own. This burst of new competi- n could crimp profits since it comes just wireless growth is slowing. Researcher nford C. Bernstein & Co. expects annual ireless growth to drop from an average of % over the past five years to 6% annual- over the next five.

It's little wonder, then, that Wall Street es bleak years ahead. Citigroup Global arkets Inc. expects Verizon, which will ve revenues of $93 billion with MCI, to ost that a mere 1% annually for the next w years. The situation could be worse for SBC because AT&T, which, like MCI, is shrinking, is a bigger company. Citigroup predicts that SBC'S revenues, $99 billion with its Cingular Wireless joint venture and AT&T, will slip an average of 1% over the next few years.

GIANT VS. GIANT

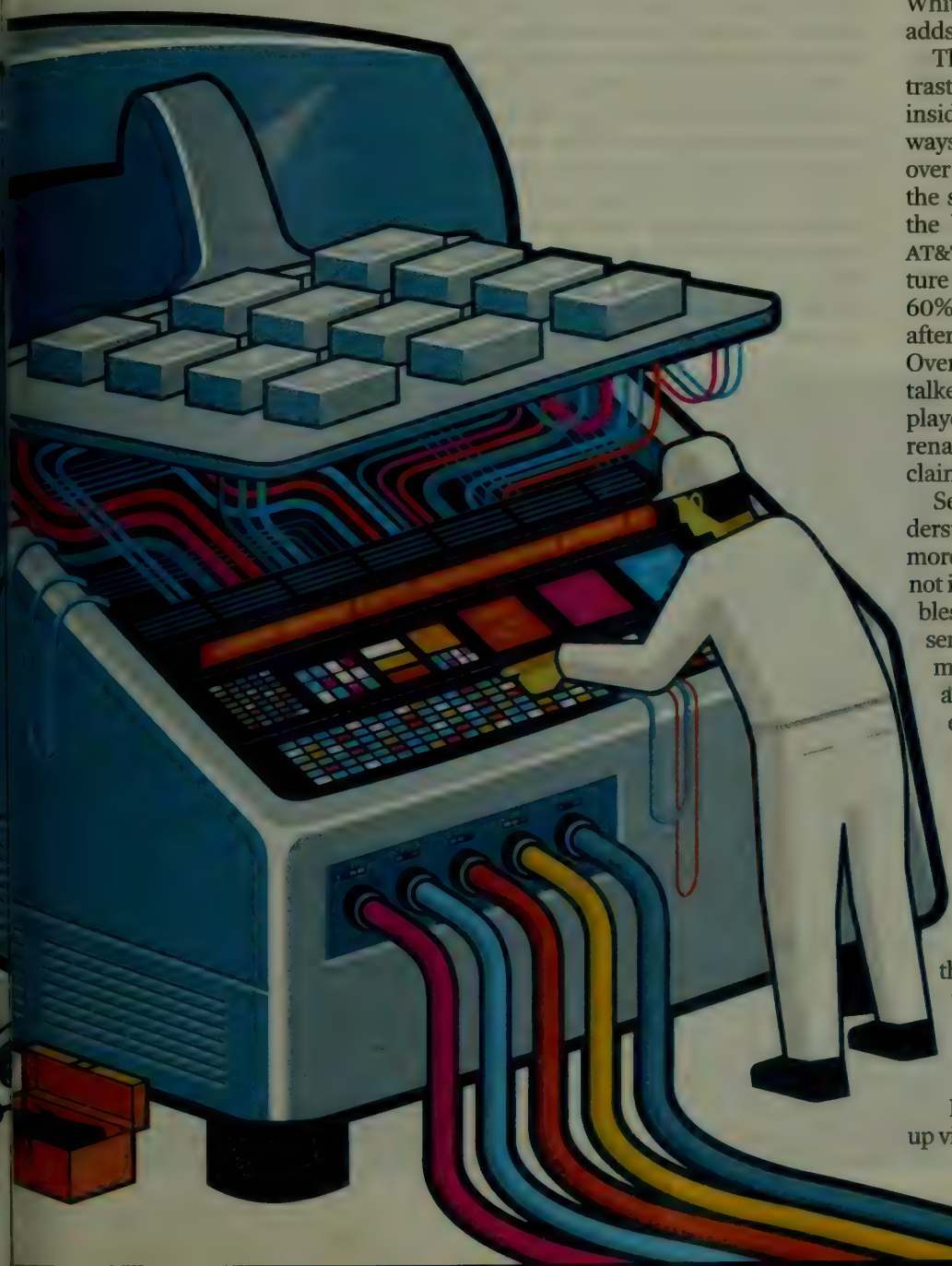
TO GOOSE THEIR growth prospects, Whitacre and Seidenberg know they need to move aggressively into new markets. The most important will be corporate services, TV, and broadband, including Internet telephone service similar to the kind that upstarts such as Vonage are offering. These can be pricey undertakings. Verizon plans to invest at least $10 billion to lay fiber-optic lines to millions of homes so it can offer extra-fast Net connections and TV services. Seidenberg vows the investments will be well worth it. "What is the total cable and media industry worth? $120 billion? That sounds like free money to us," he says.

The two giants will be pushed into tangling with each other more than ever before, too. They've already stepped up their rivalry in wireless. Next, with the acquisitions of AT&T and MCI, will come corporate services and Internet calling. Net technology is now developed enough that it will be easy for Whitacre and Seidenberg to compete for customers in each other's territories. AT&T has already been pushing Internet calling, so once SBC closes its deal, it will be in direct competition with Verizon in all of its top markets, including New York, Philadelphia, Boston, and Los Angeles. "We're fixing to get into [Internet phone service] big time once the AT&T acquisition is done," says Whitacre. Competition with Verizon, he adds, "will pick up a lot."

The struggle offers an intriguing contrast in styles. Whitacre, called "Big Ed" inside SBC, is known for his aggressive ways. Through a string of acquisitions over the past 10 years, he has transformed the smallest Baby Bell into what will be the biggest telecom company after the AT&T deal closes. Cingular, a joint venture with BellSouth in which SBC owns 60%, became the largest wireless player after acquiring AT&T Wireless last year. Over the years, Whitacre frequently talked about wanting to build the biggest player in the industry, and he planned to rename his company AT&T on Oct. 27, reclaiming the Ma Bell mantle.

Seidenberg, a Bronx native, is more understated. He downplays the prospect of more rivalry with Whitacre and says: "It's not important to me who's got bigger marbles." He tends to manage through consensus rather than fiat. When Seidenberg merged his NYNEX with Bell Atlantic and then GTE, he gave up the chief executive post twice, submerging his own ambition to smooth the corporate integrations. In contrast, Whitacre negotiated the exits of chief executives at Pacific Telesis Group and Ameritech when he bought those companies so he could run the show on his own.

How the telecom titans manage their way through these difficult times will help define what the communications industry looks like in the years ahead. If they succeed in their efforts, U.S. consumers could surf the Internet from their couches and pull up video Web sites as easily as they now get cable channels. Wireless phone



service could become as advanced as in any part of the world. And corporate customers will see new combinations of wireless and traditional calling. But if Whitacre and Seidenberg stumble, they may pull back on their investments and put off the introduction of new services. "You're talking about the industry's 800-pound gorillas. They'll play a big role in how much innovation occurs," says Raul Katz, chief executive at consultant Adventis Corp.

NEW TV FEATURES

PERHAPS THE MOST important, and challenging, foray for the two men is the television business. Comcast and the other cable companies have swiped 4.4 million phone customers, and the figure continues to rise. So getting into TV is about more than providing Verizon and SBC with the opportunity for new revenues. It's a defensive move that will let them offer customers the same bundles of voice and video that the cable players do. "They've got to do it," says analyst John C. Hodulik of UBS Securities. "The cable industry has already proven it can take share in the voice market."

Seidenberg and Whitacre have somewhat different approaches to the TV market. Seidenberg is pursuing a more expensive route, stringing fiber-optic lines directly into people's homes. Whitacre is running fiber into neighborhoods and using the existing copper from there to deliver video. He figures that'll let him get into the television business more quickly and cheaply than Verizon. Whitacre expects to hook up about 18 million homes over the next three years for $5 billion. Analysts think Verizon will have to spend the same amount of money and time to hit 10 million homes. "I didn't want to tear up everybody's driveways and streets," says Whitacre.

Both companies say they plan to bring more innovation to the television world. Ernest J. Carey, SBC's vice-president for advanced network technologies, offered a sneak peak of his company's TV service in its downtown San Antonio offices. It includes several features not available on standard cable television. One of them, called "browse," lets users change channels and see the new program in a small window while the old program runs in the background with the audio. Another feature will allow you to create your own channel, stocking it with prerecorded or live shows. SBC plans to launch the service broadly next year.

Verizon, which is offering its TV service in one market so far, is pushing innovative features, too. Chris Kroeger, a resident of Keller, Tex., who recently switched from Dish Network to Verizon TV, says he likes that he can watch one show and record another, something he couldn't do before. He also gets more channels and more choice of on-demand video than he did with Dish.

Verizon's early efforts offer some promise. Since it began marketing TV service in Keller in September, Verizon has signed up 25% of the customers in that market—hitting the high end of its goal in a matter of weeks. The cable giants have noticed. "We take [the threat from phone companies] very seriously," says Comcast CEO Brian L. Roberts. UBS' Hodulik predicts that by 2010, Verizon will get $2.2 billion in revenues from video, and SBC will pull in $1.8 billion.

Whitacre and Seidenberg will slug it out with the cable companies in the broadband market, too. So far the cable players have had the lead in supplying speedy Internet connections to consumers. By offering lower prices and higher speeds, they've signed up about 22 million U.S. households out of a total of 39 million that have broadband.

But now SBC and Verizon are getting more aggressive. Both companie[illegible] dropped their prices for broadban[illegible] low as $15 a month and are cranki[illegible] speeds. Verizon is beginning to use [illegible] fiber to offer Net connections of as m[illegible] 30 megabits—10 times as fast as sta[illegible] cable service and 20 times that o[illegible] phone-company service. Some a[illegible] think that will help them close th[illegible] with cable rivals. UBS expects te[illegible] companies to end 2005 with 4.[illegible] broadband customers, up from 42 [illegible] year. Today, SBC is the No. 2 broa[illegible] provider in the country, with 6.5 m[illegible] customers, behind Comcast. Verizo[illegible] 4.1 million broadband subscribers.

The critical battle will be over t[illegible] million to 35 million households th[illegible] have dial-up Internet service and a[illegible] ly to switch to broadband over the ne[illegible] years. That market is worth $10 bil[illegible] $14 billion in broadband fees alone.

Seidenberg, for one, believes b[illegible] band service is just the start. Once [illegible] zon has that kind of pipe into custo[illegible] homes, he figures the company w[illegible] able to sell all sorts of extras. On a [illegible] fall day in his office in Manhattan [illegible] normally sedate CEO bounds out [illegible] chair to show off one such possibili[illegible] something called Verizon One P[illegible] which looks like an oversize office p[illegible] with an extra-large color screen a[illegible] cordless handset. Seidenberg fiddles [illegible]

Call To Arms

Forced by competitors to embrace Internet innovations, phone giants such as Verizon and SBC are shifting their focus to new digital services

LANDLINE Headed for history books

OLD PHONE COMPA[illegible]

LOCAL PHONE SERVICE Usual[illegible] got charged for local phone servi[illegible] based on the number of calls you [illegible] and the length of those calls. Fee [illegible] were dizzyingly complex. This bu[illegible] was dominated by the original M[illegible] AT&T, until the company's 1984 br[illegible] and afterward by Baby Bells such [illegible] Atlantic and Pacific Telesis.

LONG DISTANCE Remember wh[illegible] AT&T used to charge one rate for [illegible] St. Louis and another for calling L[illegible] geles? Or when it was cheaper to make long-distance c[illegible] ter 9 p.m.? How quaint. The old long-distance business [illegible] appearing with the rise of wireless and Internet calling. Long-distance leader AT&T has seen its retail customer[illegible] from 60 million in 2000 to 19 million now.

CORPORATE TELECOM SERVICE AT&T and MCI, long [illegible] major providers of communication services to corpora[illegible] had expected to see rivalry from Verizon, SBC, and Bell[illegible] when those companies won regulatory approval to get [illegible] long distance a few years back. Instead, SBC and Veriz[illegible] acquiring AT&T and MCI, respectively. After the acquisit[illegible] Verizon and SBC will control 80% of the corporate mar[illegible]

GETTY IMAGES

ED WHITACRE

> "[Net upstarts] don't have any fiber out there. They don't have any wires.... They use my lines for free—and that's bull."
>
> *– Edward Whitacre, CEO, SBC Communications*

> "Before we get suicidal, we need to apply some adult thinking to this. It's not the death of anything. It just forces us to change faster."
>
> *– Ivan Seidenberg, CEO, Verizon Communications*

IVAN SEIDENBERG

e keys and demonstrates that the one can collect voice mail from your ireless and wire-line phones, e-mail m your computer, and updates from e Web on local weather and news. 'hat's innovation," beams Seidenberg. Ve think broadband will eventually cre- e new revenue streams for us the same ay wireless created new revenue eams for us over the last 10 years."

ORPORATE PUSH

EW REVENUES WILL be difficult to me by in the corporate market. As SBC and Verizon close on their acquisitions of AT&T and MCI, they'll be taking over businesses that have been in steep decline for years. AT&T is expected to see revenues drop 13% this year, to $26.5 billion, while its net income hits $1.4 billion, predicts Citigroup. MCI's revenues are expected to slide 10%, to $18.5 billion, on earnings of $32 million. While the companies are best known for selling long-distance phone service to consumers, Whitacre and Seidenberg are buying them because they sell sophisticated services to companies, including consulting and security for computer networks.

Seidenberg says he hopes to stem the revenue decline by selling more wireless services to MCI customers. The idea is that corporate customers would get everything from consolidated bills to the ability to track internal packages with global-positioning technology. "We like the idea of how the two groups complement each other," says Peter Whatnell, chief information officer at Sunoco Inc.

There's another benefit to the acquisitions that Whitacre and Seidenberg are less vocal about. After the mergers, their two companies will control about 80% of the market for corporate services, compared with the 65% that MCI and AT&T had between them. Some analysts think that will help stabilize prices in the corporate market. But it has prompted howls of protests from the few remaining rivals, who believe the acquisitions will undercut competition. "The proposed mergers are bad for the business community," says Heather Burnett Gold, senior vice-president for government relations at XO Communications Inc., a provider of corporate telecom services. "Companies are seriously concerned about the impact of the mergers on rates, innovation, and service quality." Such concerns are one reason the Justice Dept. may require divestitures or other concessions before approving the mergers.

Of course, cable companies and Internet startups are working on plenty of new tricks. Comcast's Roberts expects to offer Internet telephone services to half of the company's homes by yearend and all of them by the end of next year. "It's just the beginning," he says.

Back in Chicago, that's one thing Whitacre agrees with. Proclaiming the death of telecom misses the point, he says. His company is changing rapidly to tackle the competitive threats, and his efforts will change large swaths of the business world. "We have stayed focused and we've invested for the long term so the business survives and does well," he insists. "Anybody who would say otherwise is pulling something out of their eye." ■

–By Spencer E. Ante in New York and Roger O. Crockett in Chicago

W PHONE COMPANY

ADBAND Consumers are moving d a world where they will pay their m provider a flat fee for a broadband ction, and all their phone calls, local ng-distance, will be included in that essence, phone service is becoming mail or instant messaging—free our Net connection. But broadband, the old local phone business, is no poly. Phone companies will have g it out with cable giants and other ivals.

FIBER OPTIC CABLE
Modern workhorse

LESS Once a rare gadget for the wealthy, mobile phones w carried by grandmothers and 6-year-olds. Last year mber of wireless subscribers, 181 million, surpassed the er of phone lines in homes, 178 million. But the et is extremely competitive. On Oct. 24 cable giant ast said it's negotiating with Sprint Nextel to enter usiness.

O The telecom titans are laying fiber optic cables so they can r television service to their phone customers. It's a massive taking: Verizon plans to spend $10 billion to get in the game. it has paid off—in the first market it has offered TV it has won f the market.

BusinessWeek online For Q&As with SBC CEO Ed Whitacre, Verizon CEO Ivan Seidenberg, and Cingular CEO Stan Sigman, go to www.businessweek.com/extras

(CLOCKWISE FROM LEFT) PHOTOGRAPHS BY JUSTIN SULLIVAN/GETTY IMAGES; BILL PUGLIANO/GETTY IMAGES; GETTY IMAGES

COMMENTARY

BY EMILY THORNTON

Refco: The Reckoning

Perils lurk in the shadows of private finance. Will investors learn

IF INVESTORS NEEDED a wake-up call about the potentially dangerous flood of money surging into private equity firms and hedge funds, they're getting it with the collapse of Refco Inc. Clients continue to flee the giant derivatives dealer that buyout legend Thomas H. Lee took public just two months ago. In bankruptcy court, other investment groups haggle over Refco's surviving futures-trading business. And federal investigators are expanding their search for wrongdoers beyond ousted CEO Phillip R. Bennett. He has been charged with fraud in a scheme that employed a New Jersey hedge fund to help hide $430 million in debt owed to his former company.

After a series of hedge-fund implosions in recent months, the Refco fiasco offers only the latest warning that peril lurks in arcane and secretive corners of the financial world. Investors frustrated with a lackluster stock market have pumped more than $1 trillion into lightly regulated hedge funds and private-equity firms, much of it in the past few years. Both types of investment pools promise outsize returns, and the technical distinctions between them are blurring. They are snapping up dozens of companies. Investment banks and auditors are rushing to help them realize gains by reselling those acquisitions or taking them public. Impressed investors are now giving the funds and buyout firms even more money—starting the cycle all over again.

But some experts fear that too much money chasing too few good opportunities for investment will lead to further hedge fund blowups—and possibly to future Refcos. Pointing to the late 1980s, Steven Kaplan, a professor at the University of Chicago Graduate School of Business, says: "The last time you had so much capital sloshing around and easy [lending] markets, a lot of deals were done with marginal companies that probably should not have been."

Responsibility doesn't rest only with the cash-bloated funds and buyout groups. Maj in vestment banks and auditors are giving stamps of appro l initial public offerings that emerge from the murky priva in vestment world. Some sophisticated investors are growi in creasingly distrustful. "There is no way you can rely on a at ditor or an investment bank for a seal of approval r guarantee of no chicanery," says veteran money ma ge Michael F. Holland at Holland & Co. "The lesson to be le n from Refco is that you must do sleuth work yourself."

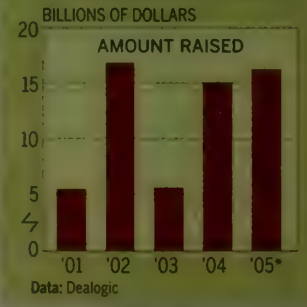
Yet the flood of money continues. Investors have handed ve at least $65 billion to buyout firms so far this year and a e pected to give them a further $85 billion in 2006, estimate n banker who tracks the field. Meantime, investors gave hedge funds an additional $9 billion in the third quarter of this year alone, according to Hedge Fund Research Inc. Nothing if not confident, Thomas H. Lee Partners is starting a new $7.5 billion fund, despite the Refco scandal, says a person familiar with the Boston firm. And investors are already lining up. The Securities & Exchange Commission is moving ahead with a mild new requirement that hedge-fund mana e must register with the agency beginning in February. But o advocates and critics of the rule agree that it will only ma e modest difference.

Refco's bankruptcy proceedings have focused on the auc n ing of its most valuable asset: an ever-shrinking futures bro e age. The company agreed on O to sell the unit for $768 millio to private-equity investor J. Chr pher Flowers. But Flowers ba e out after a group of rivals turne in bankruptcy court in New this week, including Intera Brokers Group LLC and an in ment arm of Dubai's governm The court plans to auction the on Nov. 9, but customers streaming out, leaving Refco $3.4 billion of deposits, down f $7.5 billion before Bennett's all misdeeds came to light.

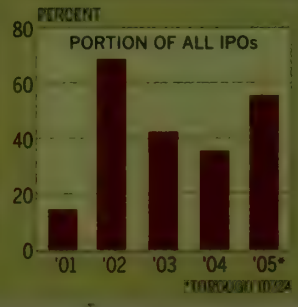
Investing in the companies

A TIDAL WAVE OF MONEY

IPO's backed by private investment firms head for a record...



...and such deals are half the total of new IPO money



Data: Dealogic

> "There is no way you can rely on an auditor or an investment bank for a seal of approval or a guarantee of no chicanery."
>
> *—Money manager Michael Holland, Holland & Co.*

buyout firms and hedge funds take public is risky. The returns of such IPOs so far this year range from more than 100% to complete wipeouts like Refco. The number of these initial offerings has nearly tripled in the past four years, to 65 so far this year, according to research firm Dealogic. These IPOs account for 55% of all of the initial-offering money raised in 2005.

Lee Partners has told its investors that it did ex-sive due diligence before buying into Refco last year. "This is Enron; this is a real business," says a person familiar with Lee, nting to the vigorous bidding for Refco's remains. Still, Lee's ent IPO track record isn't pretty. The three companies it took blic prior to Refco are trading below their offering price by an rage of 26%. The firm's long-term results are much better: 11 of 12 earlier deals have been big winners. Recent losers such Warner Music haven't been on the market long enough to ke a final judgment, argues the person familiar with Lee.

n theory, Wall Street has gatekeepers—the major investment aks—to scrutinize dubious deals. But in practice, the banks hungry for fees and sometimes appear to take this critical more lightly than the public expects. The federal courts have d that banks underwriting securities can bear legal respon-lity to investigate and verify the information presented to in-tors in a public offering. That's what U.S. District Judge hise Cote of New York wrote in a ruling last December in the gle of litigation that followed WorldCom's collapse in 2002. after years of reforms designed to avoid a repeat of Wall eet scandals, says John C. Coffee, a securities-law professor Columbia University Law School, "our current system of due gence by underwriters seems to be dysfunctional." Investment banks, he adds, "are doing inadequate due diligence to catch the kind of frauds that should be caught."

Indeed, even when serious problems surface, some banks are still willing to take companies public. Refco's underwriters—Credit Suisse First Boston, Goldman Sachs, and Bank of America—may have been ignorant of Bennett's alleged fraud. But they moved ahead with the IPO even though there were substantial deficiencies in the way the company handled its books, according to its own prospectus. The shareholder lawsuits are already flying. Bank of America says it will defend itself "vigorously" in court. CSFB and Goldman declined comment.

Outwitting the Auditors

UP UNTIL SEPTEMBER—a month after the IPO—Refco's auditor, Grant Thornton LLP, had failed to pick up on Bennett's alleged concealment of a rogue $430 million receivable. The accounting firm did warn of the financial-control problems. But Bennett seems to have outwitted the auditor by shuffling the bad debt between his private company and a New Jersey hedge fund, according to the federal criminal complaint. The shifts, to the Liberty Corner fund, allegedly let him avoid admitting a related-party transaction, an admission that would have weakened Refco's financial standing. Grant Thornton was assured that the highly mobile debt was owed by an outside party that could repay it, according to a person familiar with the situation. The auditor was willing to believe this claim because Refco was in the business of lending money, this person says. (Bennett has paid off the debt with a bank loan.)

Assessing the enormous array of complex transactions such as the ones that Refco handled has become an "auditor's night-

mare," says Robert Willens, an accounting-industry analyst at Lehman Brothers Inc. Nevertheless, "it was surprising that the auditors wouldn't have been checking very carefully on an issue like this," Donald C. Langevoort, a securities-law authority at Georgetown University in Washington, contends. Grant Thornton said in a statement that it had acted appropriately, noting that Bennett's deception evaded "numerous other detailed financial inspections performed by many of the most well-respected financial institutions in the country." Liberty Corner has stated that it did not know about Bennett's alleged fraud. A hearing in the criminal case was scheduled for Oct. 31 in federal court in New York.

Repeated Scrapes

ONE MIGHT HAVE approached Refco with skepticism. Throughout the 1990s it had repeated scrapes with regulators, and its commodities unit was hardly the type of stable, dull business that buyout firms have traditionally targeted. But Bennett, who became CEO in 1998, was perceived as having cleaned up the company. Buying a majority stake in Refco in 2004 enabled Lee Partners to tap the white-hot futures-trading market. As a titan in the rough-and-tumble futures arena, Refco no doubt looked as if it might repeat the success of the Chicago Mercantile Exchange, which has seen its stock soar from a $35 offering price in late 2002 to about $360 now.

Don't weep for Lee Partners or its investors. Even with the Refco debacle, they'll come out just fine. First, Lee sold a big chunk of its Refco stake in the Aug. 11 IPO, clearing $210 million. The firm retains 38% of Refco, worth more than $1.4 billion two weeks ago but now l get wiped out in the bankrupt N ertheless, this deal was mer out of 20 investments made b Lee's private-equity funds. E with a total write-down of th R deal, that Lee fund still has pr rific numbers," says Josh L professor at Harvard B School. The fund in question g erating an overall return o than 30%, says the person f with the Lee firm.

Refco's fiasco "points to failures at all levels," says one investor advocate

And what about the regulators? The SEC relies on infor provided by company directors, officers, auditors, and ba and tries to hold them accountable if anything goes wrong C gress has never asked the SEC to do more than eyeball ments to see that they conform to disclosure standard Georgetown's Langevoort. The Refco trauma may lead to tougher SEC oversight, but "almost no amount of reg would have cured or caught" a CEO determined to fu numbers, says David B.H. Martin, former director of the S vision of corporate finance.

Maybe so. But Refco's fiasco "points to failures at all says Barbara Roper, director of investor protection at th sumer Federation of America. "How many blowups do w to suffer before investment banks, auditors, regulators, a phisticated investors start to take these risks seriously?"

–With Aaron Pressman in Boston, Joseph Weber in C and Amy Borrus in Wash

A Swift Decline

Refco went from a celebrated initial public offering to disgrace in just two months.

RINGING THE BELL Bennett opens a session at the New York Stock Exchange on Sept. 9

CHARGED Bennett leaving the court

AUCTION Flowers in an early offer

AUG. 11 Refco's **IPO** at $22 a share gains 25% on its first day; four weeks later the shares exceed $30.

OCT. 10 CEO **Phillip Bennett** is suspended; the company says he concealed $430 million in bad debt owed to Refco. Shares fall 45%.

OCT. 12 Prosecutors charge **Bennett** with securities fraud.

OCT. 13 Refco **freezes accounts** in its capital-markets unit, which traded derivatives—and which the prosecutors allege was used, with a New Jersey hedge fund, to help hide debt.

OCT. 17 Refco files for **Chapter 11** protection on behalf of the parent company and 23 affiliates. It keeps the futures unit out of bankruptcy-law proceedings and arranges to sell it to private-equity firm J.C. Flowers for $768 million.

OCT. 18 New York Stock Exchange **suspends trading** in the company's stock and makes preliminary moves to delist it.

OCT. 24–25 **Flowers** withdraws from bidding for the futures business. Broker-dealer Interactive Brokers offers $858 million i competition with oth suitors. The deposit Refco's futures customers reach $3 billion, down from $ billion before the scandal. The share p heads toward $1 in over-the-counter trading.

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Take Your Best Shot, Punk

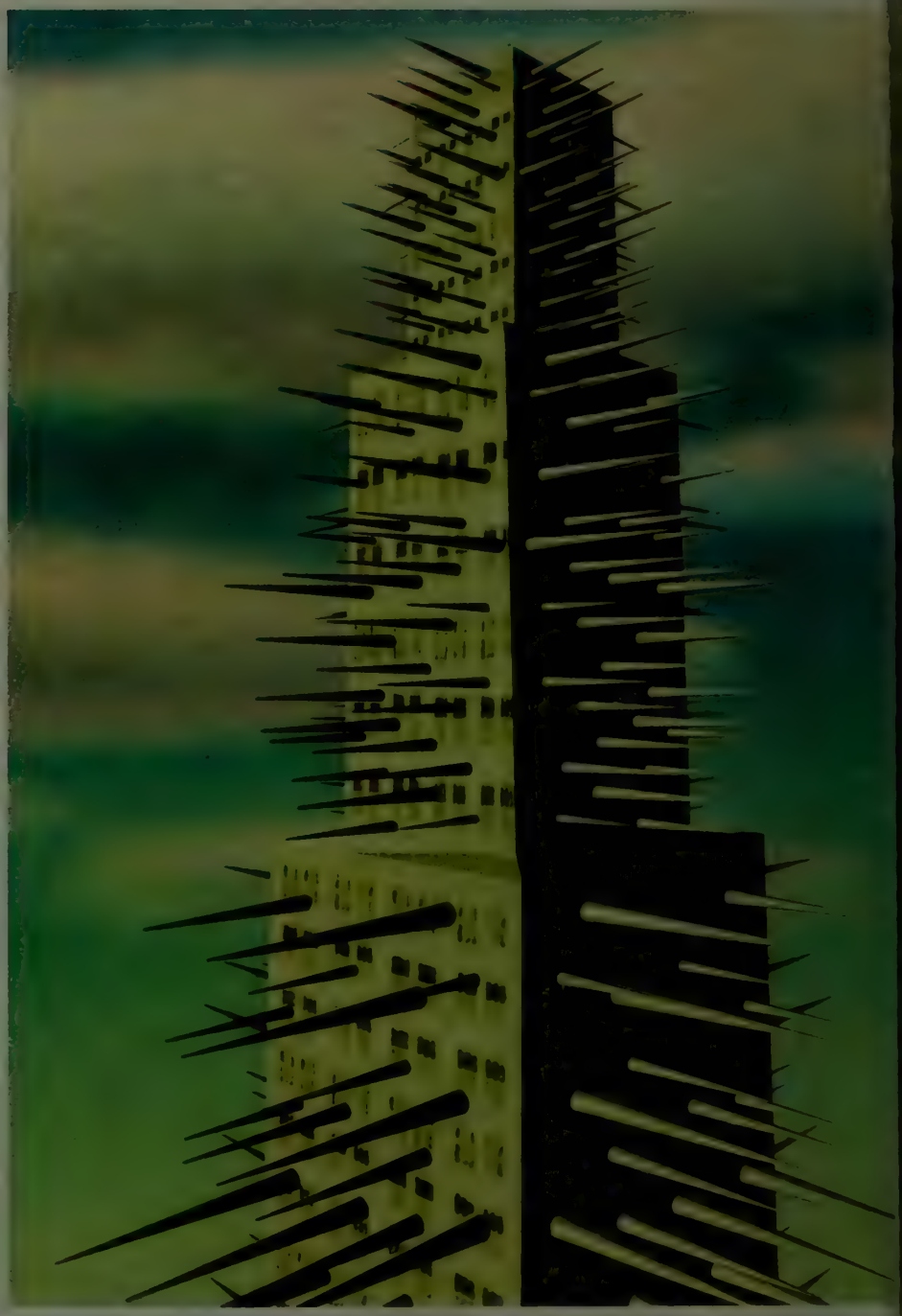
Corporate boards have devised elaborate new defenses against activist hedge funds

HEDGE FUNDS ARE USUally savvy operators, but sometimes even they get outmaneuvered by a simple tactic. New York-based Pembridge Capital Management LLC wanted change at iconic trading-card outfit Topps Co. and was set to nominate three directors. Before its annual meeting on June 30, Topps appeared to meet one of Pembridge's key demands when it hired investment bank Lehman Brothers Inc. to explore a sale of its candy unit. So the board asked Pembridge to withdraw its nominees, which it did. Then, on Sept. 12, the company announced that it wasn't selling the candy business after all. Pembridge had fallen victim to one of the newest defenses thrown up by companies desperate to fight off tough demands or a takeover—a ploy called the head fake. Topps did not return phone calls asking for comment.

After four years of rising shareholder activism, companies are striking back. Not only are they fighting a rearguard action to keep classic takeover defenses such as poison pills—which companies use to dilute a raider's stake by issuing new shares to friendly shareholders—but they're also devising ever-more-subtle maneuvers to beat back would-be acquirers. Tactics range from stalling dissidents by half-heartedly pursuing a deal to avoiding the election of new directors by not holding an annual meeting. An especially potent defense: Letting the company's largest creditor demand immediate payment in the event of a takeover. Says Chris Young, director and co-head of M&A research at Institutional Shareholder Services in Rockville, Md.: "If there's a particular threat, companies will resort to a takeover defense in the short-term."

Companies are doing exactly tha cause they face an exploding numb activist hedge funds. Financier Ca Icahn has banded together with h funds to agitate for change at T Warner Inc. Hedge funds have wo cent proxy contests at Blockbuster and fund-management firm BKF Ca Group Inc. And they've secured key cessions after threatening proxy figh energy outfit Kerr-McGee Corp. health-care provider Beverly Enterpr

The onslaught from hedge fund stimulating the creativity of compa trying to thwart what they decry as qu buck artists. After investing nearly $ million in Little Rock information-m agement company Acxiom Corp.—



tching its stock price drop—San Fran-
co hedge fund ValueAct Capital LP ap-
oached the company in May about
ding a director to its board. The next
onth, Acxiom's board unveiled an un-
ual policy: It barred investors with a sig-
icant holding in the company from serv-
; on the board "due to the possibility of
nflicts of interest." What's more, the rule
dn't affect any existing directors.

LAYING TACTICS

LUEACT SAYS the policy simply pro-
ts the status quo. "It becomes a
eover defense," complains managing
tner Jeffrey W. Ubben. "My guess is
t [Acxiom Chairman and Chief Execu-
e Charles D. Morgan] has never been
llenged by his board." Without dis-
ting voices, the board can easily turn
wn buyout offers, Ubben adds. In July
board rejected ValueAct's bid for the
t of Acxiom it didn't already own for
3 a share, a 25% premium over the
rket value at the time. On Oct.24,
ueAct upped the offer to $25. Acxiom
lined to comment.

Delaying Securities & Exchange Com-
ssion filings also can be an effective de-
se, even if unintended. In July, 2004,
cago-based health-club chain Bally
al Fitness Corp. agreed to drop a tough
son pill to avert a proxy battle with Los
geles hedge fund Liberation Invest-
nt Group LLC. Liberation, which owns
of Bally's shares, believed this cleared
way for a sale of the unprofitable com-
y. A month later,
ugh, Bally said it had
covered accounting
ches and would have to
ew several years of re-
s. The company hasn't
l a financial report with
SEC since, allowing it to
off its annual meeting
ler SEC rules. Activists
such a move is some-
es intended to avoid
tions that could change
trol of the board. Final-
n Oct. 6, Liberation won a lawsuit in
aware, where state law mandates no
re than 13 months between annual
etings, forcing Bally to hold its meet-
on Jan. 26. A source familiar with the
ter says the postponement of the an-
l meeting was "not in any way, shape,
orm anything I would categorize as a
eover defense."

n addition to tardy SEC filings, confi-
tiality agreements shielded Bally from
tile takeovers. In May it put its Crunch
ess division on the block. But to have a
look at Crunch's books, prospective buyers had to sign an agreement not to make a hostile bid for the parent.

More suits are likely as new defenses are tested. A 1985 court case that pitted oil company Unocal Corp. against financier T. Boone Pickens set the precedent. The Delaware Supreme Court ruled that directors must show they had good reason to think a "threat to corporate policy and effectiveness existed." Moreover, they must show that the defense is "reasonable in light of the threat posed." Onerous defenses that simply entrench boards won't fly.

The new devices to fend off unwanted suitors are popping up at the same time that companies are only slowly dismantling their traditional defenses, despite post-Enron efforts to curb them. Since 2002 the number of Standard & Poor's 500-stock index companies with a staggered board—which prevents shareholders from replacing a majority of directors in one election—has fallen only 13%, to 266, according to researcher FactSet TrueCourse Inc. In the same period the number of S&P companies with a poison pill has dropped just 14%, to 260.

Companies say they need these defenses for a simple reason: While activist hedge funds sometimes portray themselves as shareholders' guardian angels, companies argue that they're anything but. Selling a company may let a hedge fund book healthy returns in one year, companies say, but those gains may come at the expense of a much larger payoff for shareholders over the long term. "This has raised the question of whether such short-term investors should be entitled to shareholder rights in outright conflict with long-term investors," SEC Commissioner Roel C. Campos told a recent hedge-fund conference.

Of course, not all hedge funds are short-term investors. ValueAct Capital, for example, invests for three to five years. Moreover, securities laws don't ascribe different rights to shareholders based on length of ownership. "The whole idea that you need to get tenured as a shareholder is preposterous," says Robert L. Chapman Jr., a principal at El Segundo (Calif.), hedge fund Chapman Capital Management LLC.

The new techniques don't always succeed. Burton Capital Management LLC, a Greenwich (Conn.) hedge fund, wanted to appoint new directors and management at Englewood (Colo.) printing company Cenveo Inc. after its stock price had fallen 53% in five years. But Cenveo's board would have none of it. On Apr. 17 directors voted to let the company's largest creditor demand immediate payment of $763 million in debt if shareholders appointed new directors without the board's approval. The message to Burton: Replace us, and you'll inherit a ruined company. But Burton continued to pursue a proxy fight. It finally reached a settlement with Cenveo on Sept. 9 and got the directors to approve its eight nominees to the board. Cenveo officials didn't return phone calls.

The new corporate arsenal may have the unintended consequence of emboldening activists who enjoy a good fight. Chapman, one of the most feared activist hedge-fund managers, recently returned from a sabbatical and is preparing to relaunch his fund next year with up to $500 million. "We're putting together a war machine," he says. "By the time we get over a few billion dollars under management, no company will be safe." ■

–By Justin Hibbard in San Mateo, Calif.

Armored Fortress

Recent moves many companies are using go far beyond the classic poison pill, which triggers the issue of new shares to friendly shareholders once the stake owned by a predator exceeds a preset threshold:

INSTANT PILL Board lowers the poison-pill threshold below the amount already owned by would-be acquirers, immediately diluting their stake

VOTE STALL Company delays filing its annual report to avoid holding its annual meeting if shareholders seem likely to vote out current directors

HEAD FAKE Board announces that it has hired investment bankers to explore selling the company but never follows through

CHASTITY LOAN Company puts covenants in its bank loans to make them due immediately in the event of a takeover

STANDSTILL AGREEMENT Company offers assets for sale but requires potential buyers to agree not to make a full-scale bid for the parent

Data: *BusinessWeek*

Are the funds shareholder guardian angels or fast-buck artists?

Treading Warily In the Junkyard

High-yield bonds are a tougher sell as rates rise and economic worries grow

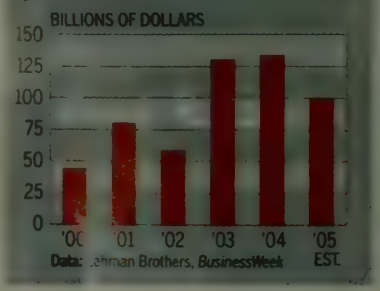
COMPANIES AND LEVERaged-buyout firms seeking to float junk bonds are facing tougher times. Increasingly, they're having to scale back the amounts they raise, pay higher interest rates, and agree to more financial restrictions. At the start of this year, the market would finance almost anything. But now investors are starting to worry about the economy, rising rates, and the fact that they were probably too lax in assessing credit risks earlier in the year. "There's a turn in the market to more risk aversion and careful credit selection," says Michael Anderson, high-yield market strategist at Lehman Brothers Inc.

Investors have other concerns, too. The heady returns from junk bonds in the past two years are fast disappearing. Despite average yields of about 7%, the total return on junk bonds is close to zero so far this year, vs. back-to-back returns of 23% and 11%, in 2003 and 2004, respectively, according to KPD Investment Advisors, a high-yield research firm. The flood of money into junk-bond mutual funds has now reversed.

In the past month alone, investors have passed up significant new offerings, including an $850 million slice of financing for the leveraged buyout of luxury retailer Neiman Marcus Group Inc. and a $500 million piece of the $1.8 billion purchase of direct-marketing company Affinion Group from Cendant Corp. They also balked at buying one-third of $550 million of bonds offered to pay a special dividend to investors in Roundy's Supermarkets Inc. Overall, investors bought a quarter less new junk paper in the nine months through September than in 2004.

A WANING APPETITE FOR HIGH YIELD

Companies are issuing fewer junk bonds



As a result, companies and LBO outfits are tapping still-booming demand in the parallel market for leveraged loans. That $235 billion market is driven by hedge funds and new investment vehicles that pool loans from multiple issuers to diversify risk and add leverage to boost returns. The loans usually have shorter maturities than bonds and floating ra than fixed interest rates. That mark sopping up borrowing the junk ma shuns, such as an extra $975 millio the Neiman buyout.

TIGHTER COVENANTS

WHILE THE LOAN alternative keeps borrowing spigot open for compani has some significant downside for junk-bond market. That's because firms are piling on more leverage creasing the risk of trouble wheneve economy next stalls and sets off defa Large LBO deals in the third quarter ried debt averaging 6.1 times earn before interest, taxes, depreciation, amortization, vs. 4.6 times in 2003 cording to LCD, a unit of Standa Poor's. The previous annual was in 1997 at 5.7 times. "Len have embraced ever more aggres financing structures," says LCD rector Christopher Donnelly.

All the same, new doubts abou market are unlikely to shut off ac for additional LBOs and acquisiti Several are pending, including proposed $15 billion LBO of H Corp. from Ford Motor, IntelSat's quisition of PanAmSat, and Donnelley's acquisition of ye pages publisher Dex Media Inc. H at their present 3.3 percentage po above 10-year Treasuries, junk-b market spreads remain cheaper the average of 4.1 percentage po over the past 12 years, accordin KDP. "The high-yield market will be encouraging to LBOs, but it wi at a higher cost and not as gener on the terms," says John Fenn, h yield market strategist at Citigr Deals financed the past six weeks h featured both higher yields and more strictive covenants, such as limits on a sales by the borrower and on using b proceeds to pay dividends, says Pau Scanlon, lead portfolio manager for hi yield funds at Putnam Investments.

The current bout of nerves am some investors isn't the first this year March and April, the junk-bond ma swooned, falling 4% as $40 billion General Motors Corp. debt was cu junk status. The GM debt amounte about 6% of outstanding junk bonds, cording to Lehman Brothers

That episode turned out to be just a ally bad case of indigestion rather tha devastating malady, and the ma bounced back. Next time around, thou investors might not be so lucky. ■

–By David Henry in New Y

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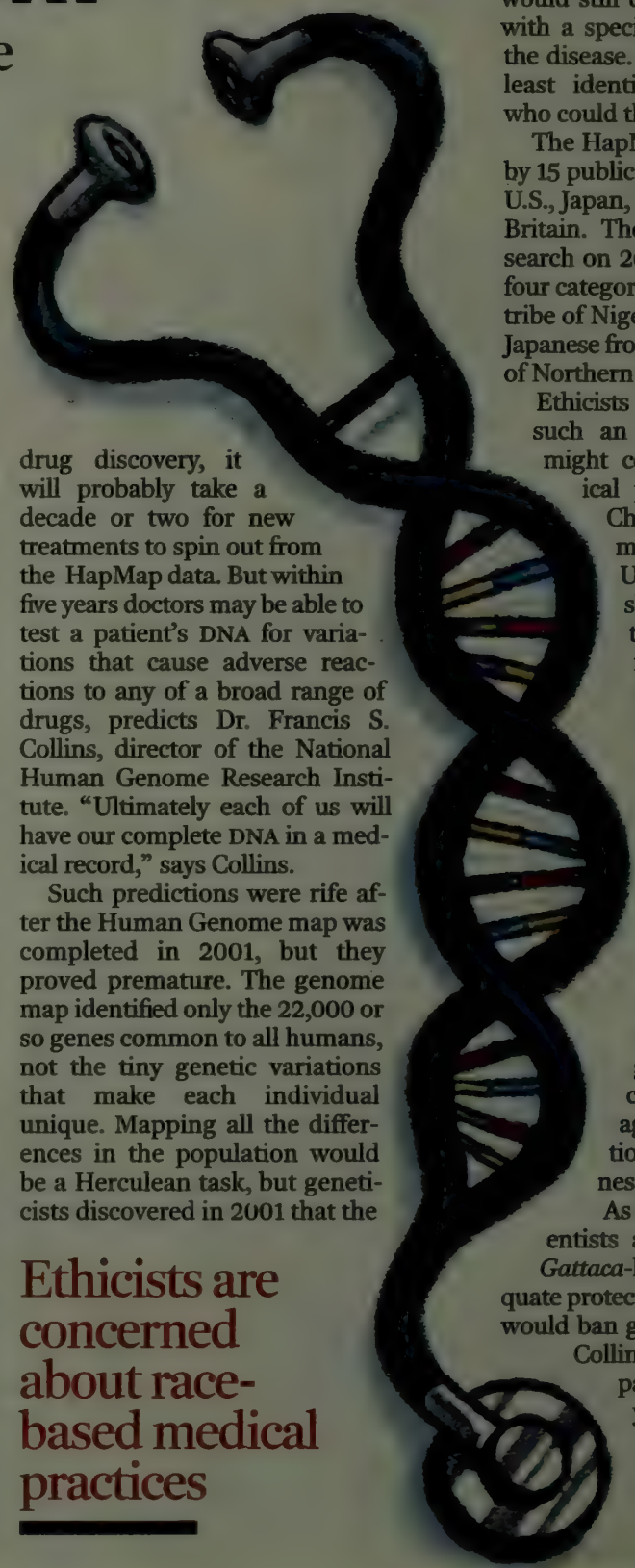
How Likely Are You To Get Sick?

A new DNA database could gauge your risk for disease



GATTACA, A SCIENCE fiction movie released in 1997, portrays a dystopian future in which a person's place in society is determined by an analysis of his or her DNA, and the likelihood of disease is ascertained at birth. The movie would seem to have little connection with reality—except that an international consortium has just completed the groundwork for a version of this future. Ultimately an individual's DNA could be decoded at an early age to spot a predisposition to illness. But here's where life improves on art: The goal will be to counter the risk of disease, not pigeonhole the person.

On Oct. 27 the three-year old International HapMap Consortium published a comprehensive catalog of more than 1 million human genetic variations, grouped in blocks called haplotypes. The DNA sequences of any two individuals are 99.9% the same, but the range of variations in the remaining 0.1% is enormous. That 0.1% is responsible for a predisposition to asthma, diabetes, cancer, heart disease, schizophrenia, and many other ailments.

The HapMap database, which is freely available to all, allows researchers to connect genetic variations to a disease. Once such a link is made, drugmakers hope to come up with a treatment that can zero in on the cause and possibly even prevent the illness. "This type of information is completely changing the way we do drug discovery," says Paul Herrling, head of corporate research for Novartis AG. "It is certainly an important step in the direction of personalized medicine."

Given the exceedingly slow pace of drug discovery, it will probably take a decade or two for new treatments to spin out from the HapMap data. But within five years doctors may be able to test a patient's DNA for variations that cause adverse reactions to any of a broad range of drugs, predicts Dr. Francis S. Collins, director of the National Human Genome Research Institute. "Ultimately each of us will have our complete DNA in a medical record," says Collins.

Such predictions were rife after the Human Genome map was completed in 2001, but they proved premature. The genome map identified only the 22,000 or so genes common to all humans, not the tiny genetic variations that make each individual unique. Mapping all the differences in the population would be a Herculean task, but geneticists discovered in 2001 that the variations regularly bunch togeth haplotype blocks.

These blocks turn up over and o the same places on the genome, ac wide range of populations. That n them likely markers for gene-base eases. By comparing people who ha same disease, such as diabetes, scie hope to find which haplotypes they in common. Lifestyle and environ would still determine whether a p with a specific variation would de the disease. But genetic testing co least identify susceptible indivi who could then avoid triggers.

The HapMap consortium was fo by 15 public and private groups fro U.S., Japan, China, Nigeria, Canada Britain. The consortium based it search on 269 DNA samples taken four categories of volunteers: the Y tribe of Nigeria, Han Chinese in Be Japanese from the Tokyo area, and p of Northern European ancestry in U

Ethicists are concerned about race-based medical practices

Ethicists have raised concerns such an ethnically based app might contribute to race-based ical practices. But Dr. Ara Chakravati, director of ge medicine at Johns Ho University, says the Ha should diminish cons tions of race in medical ment. The consortium f that the vast majority of rare and common ge variations were found the populations studie

Meanwhile, the gro close to finishing a se version of the Hap with three times as n detail. The effort is al producing results: March, using prelimi HapMap data, researc reported the discovery genetic variation that sig cantly increases the ris age-related macular deger tion, the leading cause of b ness in the elderly.

As the project moves ahead entists admit to worrying abo *Gattaca*-like future. "The only quate protection is federal legislation would ban genetic discrimination," Collins. One such bill has passed by the Senate but yet to see any action in House. Perhaps Cong should watch the movie

–By Catherine Arn

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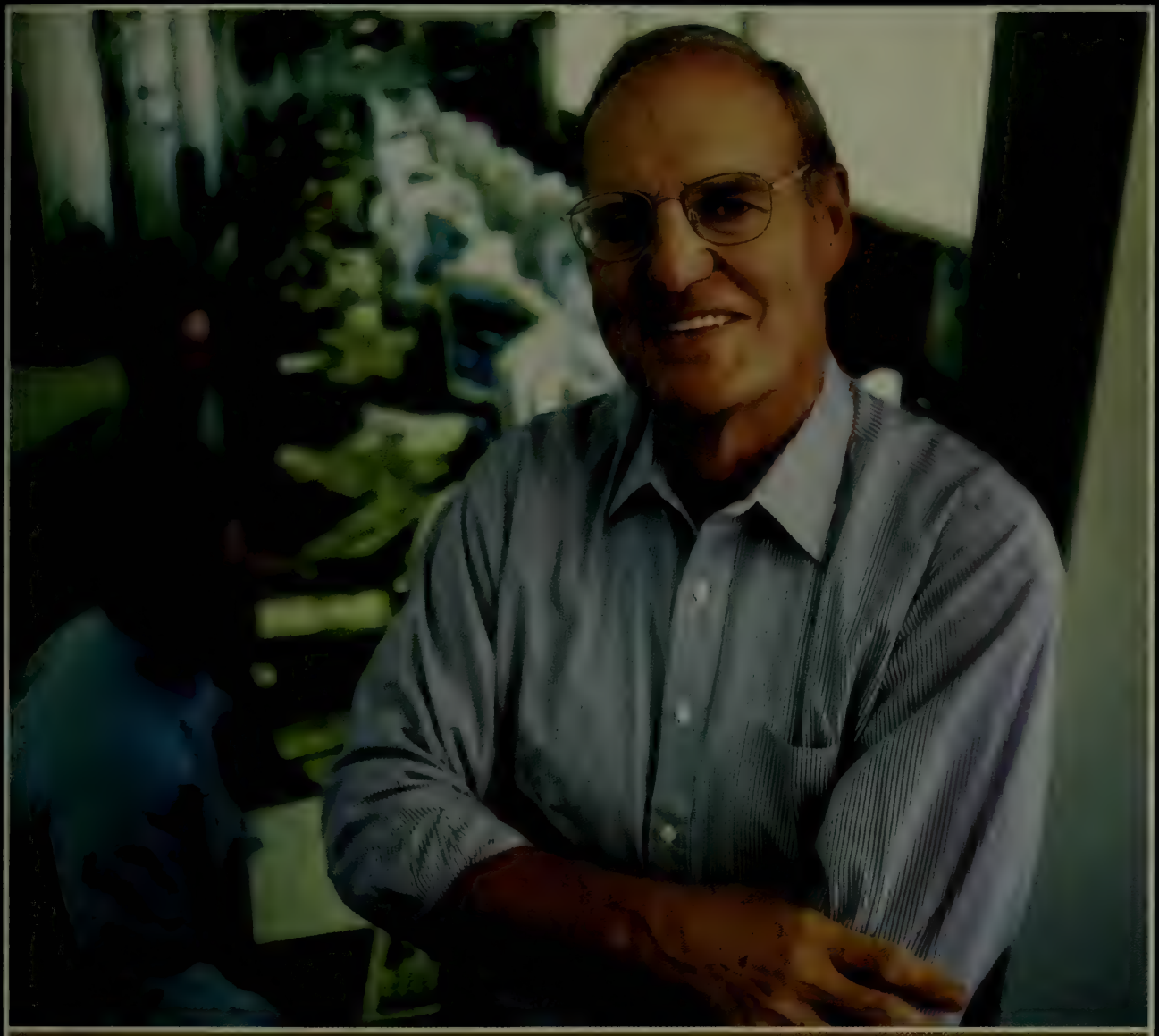

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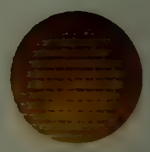

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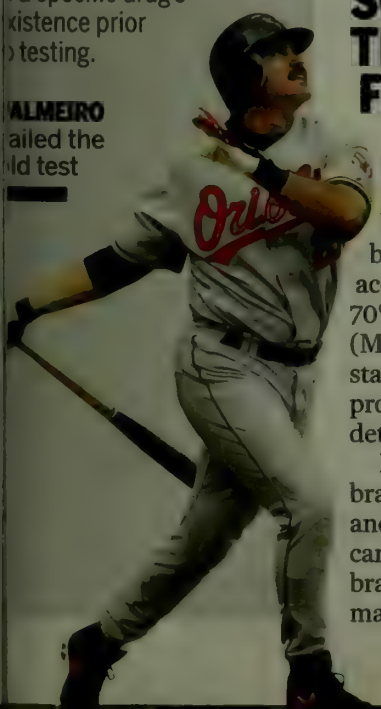
DITED BY
ATHERINE ARNST

INNOVATIONS

Teensy trucks and steroid spotters

Microscopic factories that ssemble, atom by atom, new rugs or nano-scale omputers are still a distant ream. But Rice University cientists have made a start, onstructing a materials-andling system for such a actory. It's a molecular hassis just four nanometers n length. The Rice team has sed the chassis to design a nano truck" that can carry tom-size payloads.

Athletes bulking up with teroids can avoid getting abbed—as slugger Rafael almeiro did—by using rugs not yet known to the uthorities. Current testing ethods screen blood or rine, but only look for nown drugs. Scientists at ity of Hope National Medical Center outside Los ngeles have created a new est that closes the loophole. zeros in on portions of the ells in the blood or urine ample that all steroids bind , and can thus spot uspicious molecules. So here's no need to be aware f a specific drug's xistence prior testing.



ALMEIRO
ailed the
ld test

CHANGE IN THE AIR Hurricane Wilma blows into Cuba

COMPUTER SIMULATIONS

CLIMATE CHANGE: A SHARPER PICTURE

HURRICANES KATRINA, Rita, and Wilma seem to be clear evidence that climate change is upon us. In fact, stronger hurricanes are short-term phenomena; they'll weaken in a decade or so. Now for the bad news: the most detailed computer simulation yet predicts that climate change will disrupt weather patterns for at least the rest of this century.

Researchers at Purdue University doubled their model's resolution and improved its ability to analyze the interplay of such effects as snow reflecting solar energy back into space. After running the model nonstop for five months, the results are grim. "Climate change is going to be even more dramatic than we previously thought," says Purdue's Noah Diffenbaugh. Examples of what's in store over coming decades: In the Northeast, summers will be longer and hotter. In the Southwest, heat waves will be more intense, and less water will be available. *–Otis Port*

GRAY MATTER

SCANNING THE BRAIN-FOR LIES

POLYGRAPH TESTS are used with caution these days because they are known to be highly unreliable—accuracy rates can dip below 70%. Cephos, a Pepperell (Mass.) startup, says that a standard MRI machine, used properly, could serve as a lie detector that tells the truth.

People use more brainpower when they lie, and that increased activity can be detected when the brain is scanned in a magnetic resonance imaging machine, says Cephos Chief Executive Steve Laken. In a recently completed test with the Medical University of South Carolina, 61 subjects were told to take a watch or a ring from a drawer. They then were asked a series of yes/no questions while undergoing a 40-minute MRI exam—with some subjects instructed to lie. Using software developed by Cephos to analyze images of brain activity, researchers could tell who was lying 90% of the time. Cephos is now doing a follow-up study funded by the Defense Dept. to see whether it can improve the accuracy rate. Results are expected next spring. *–Michael Arndt*

PROTEINS

PRESERVING ORGANS WITH 'ANTIFREEZE' FROM A FLEA

A TINY BUG that lives in snow may hold the key to a longer shelf life for transplant organs. Scientists at Queen's University in Kingston, Ont., isolated a so-called antifreeze protein made by the millimeter-long snow flea to defend itself against the cold. They discovered that it can

lower the freezing point of liquids by about 11 degrees Fahrenheit.

Today, donated organs for transplant must be kept at the freezing point, or slightly warmer. Queen's biochemist Laurie Graham thinks an organ treated with the snow flea's protein could be stored at lower temperatures, keeping it fresh longer. Graham first noticed the snow fleas while cross-country skiing. "It was serendipity," she says. "They looked like dots of pepper sprinkled on the snow." Their proteins might also be used to increase frost resistance in plants, and inhibit ice formation in frozen foods.

Unlikely Rebel On the Right

Meet Mike Pence, the conservative who's leading a revolt against runaway spending

GOP CONSERVATIVES IN the House have an almost robotic loyalty to the White House and to stern leaders such as Tom DeLay. How, then, to explain Mike Pence of Indiana? As a freshman in 2001, he fought President Bush's No Child Left Behind Act, which he considered a Big Government boondoggle—and was badly defeated. In his second term, he tried to scuttle Bush's $720 billion Medicare prescription benefit—and lost by a whisker. This year, Pence, horrified by exploding federal spending, led a backbench rebellion against a blank check for the costs of rebuilding after Hurricane Katrina.

But something surprising happened: He won. House leaders agreed to seek billions in spending cuts just days after DeLay insisted most of the fat had already been sweated out of the budget.

Pence, soft-spoken and prematurely gray at 46, is an unlikely rebel. An evangelical Christian and former radio talk-show host, he likes to recite Bill Cosby routines. But he has a bully pulpit for his jeremiads against runaway spending: leadership of the Republican Study Committee, a bloc of GOP budget hawks that includes more than 100 of the 231 House Republicans and is increasingly inclined to challenge its own leadership and a weakened President. While Pence has voted with Bush 95% of the time, it's the other 5% that sticks in his craw. "I've had reason to doubt [Bush's] commitment to limited government and fiscal discipline," says Pence, adding that "Hurricane Katrina laid bare a fiscal course...that was contrary to the hopes of millions of Americans."

> "I've had reason to doubt [Bush's] commitment to...fiscal discipline"

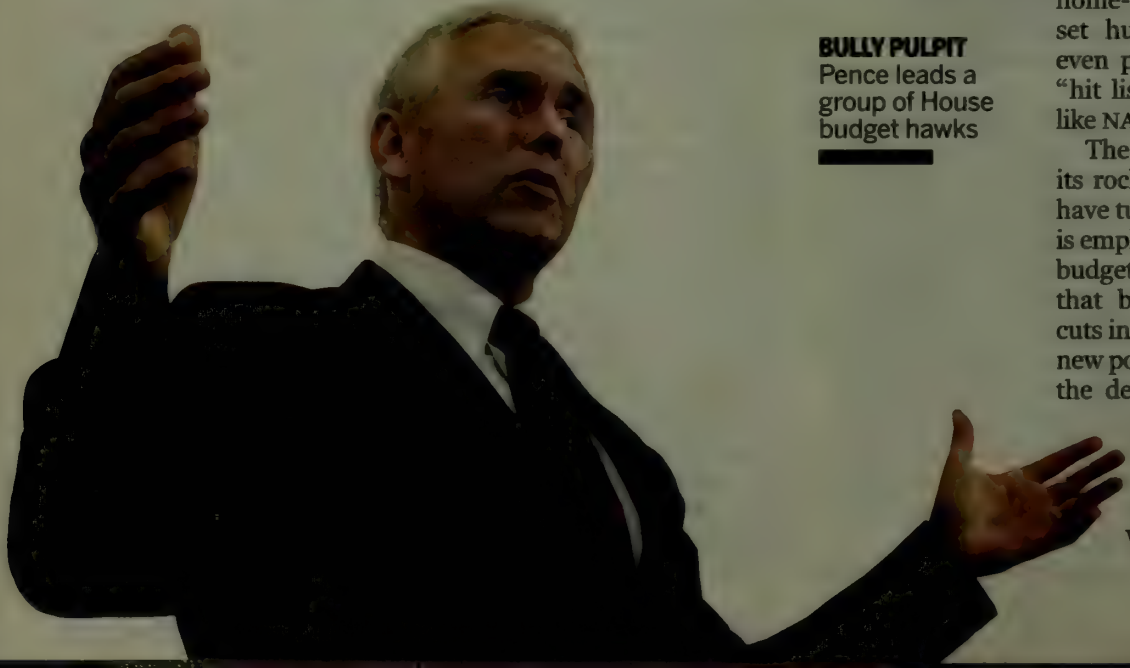
That kind of criticism has many in the business community quietly applaudi the backlash over big deficits. "Less go ernment spending tends to be good f the long-term stability of the econon which is good for business," says Dav K. Rehr, outgoing president of the N tional Beer Wholesalers Assn. But son corporate reps are concerned abo Pence's emphasis on hot-button issu such as restricting immigration and ba tling Hollywood sex, which pit hi against business interests. Indeed, cultu al concerns drove Pence & Co. to block t leadership's hand-picked choice to r place DeLay, Rules Committee Chairm David Dreier (R-Calif.), an economic co servative seen as soft on social issue That power play led many to specula that Pence eventually hopes to follow t path of his political hero, Newt Gingric to the Speakership of the House.

The grandson of an Irish immigra bus driver, Pence was working at an Inc anapolis law firm when he decided to b come a foot soldier Gingrich's conservati revolution. After fail bids for Congress in 198 and 1990, he decided th "God had other plans f my life." He became ho of a syndicated talk-rad show on 18 stations un his winning 2000 race.

As a lawmaker, he h ruffled powerful feathe by repeatedly opposi GOP proposals to expa the reach of Uncle Sam. But he hasn been a consistent foe of federal largess He backed a 2002 farm bill that steere benefits to his agricultural district. "I ha voted for my share of spending," he co cedes. In penance, he has offered up son home-state highway projects to help o set hurricane cleanup spending. He even produced a five-year, $370 billio "hit list" that targets Bush pet projec like NASA'S return-to-the-moon initiativ

The White House isn't ready to give u its rockets, but Pence's rebels appear have turned the tide. The Administratio is emphasizing the need to produce a lea budget and House leaders are demandin that balky committee chairmen mak cuts in their own fiefdoms. And Pence, th new power broker, will be in the middle the dealmaking. If he wields his clo deftly, many colleagues belie that the next Newt could be a se effacing Hoosier as comfortab quoting Scripture as the Contra With America. ■

–By Eamon Javers in Washingto



BULLY PULPIT Pence leads a group of House budget hawks

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Managing the IT Service Lifecycle: Business Needs Driving IT Decisions

During the beginning of the partnership between business and IT, solutions were limited. Businesses that adopted IT had few options and often had to modify business practices to accommodate technology. This resulted in far too great a dependency on technology; essentially holding business hostage to the directives of their IT departments.

Today, IT has matured to a point of continuing specialization and has evolved to satisfy the nuances that exist across varying business sectors. Additionally, IT produces measurable and demonstrable cost savings and return on investments that are both reliable and repeatable. IT now acts as an enabler, allowing business needs to drive business decisions. IT has evolved into a business service that can help focus on building corporate value — namely, decreasing operating costs, increasing revenue, and ensuring that business practices comply with governmental regulations and industry standards.

As a business service, the challenge for IT is managing the lifecycle of IT assets, which we define as anything or anyone attached to the network, interacting with the network, or residing within the network. This definition includes technology products and processes as well as those human resources that interact with IT systems. The methodology for managing the IT Service Lifecycle has been defined by the IT Infrastructure Library (ITIL®) model, a standard framework of best practices, as the following services:

Service Design – Businesses must first identify the IT assets that will satisfy their business need, then assess the requirements and benefits of introducing them to the company; plan the resources, approach, scope, and architect the appropriate solution.

Service Introduction – The next step is acquiring or creating the relevant IT assets, testing functionality against the stated business requirements, configuring and integrating them into the network, and finally, deploying the service into the production network.

Service Support – The business must then establish operational processes that ensure uninterrupted access to all IT services offered through the network.

Service Delivery – At the same time as a new or revised IT support service is devised, the business must also define the appropriate service levels required as those services are delivered in order to achieve stated business goals.

Service Improvement – The IT assets must be monitored for performance and functionality. This information should then be measured, compared to current business needs, and any needed adjustments made. Lastly, the process is refreshed to maintain the cycle.

IT service lifecycle management is a key component in understanding the interrelation between IT infrastructure and business needs throughout an organization. Using this model to adopt a more holistic approach, allows business needs to drive IT direction. Denali continues to promote and educate our customers on the benefits of incorporating the ideology behind this practice—that each technology decision must be seen in the context of the entire organization and that all IT efforts lead to systems and services that build corporate value. Using the IT service lifecycle management model is an example of how this can be accomplished.

To read the full report, go to www.management-reports.com/denali.asp

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Denali Advanced Integration is a company of 3MD Technologies, Inc. (3MD), a privately held Washington State corporation with gross revenues of $80 million in 2004. 3MD is a holding company for multiple operations with over 350 employees focused on IT consulting, custom manufacturing, distribution, retail, and providing IT solutions that span from large enterprise to small business. Denali is able to leverage the expertise of each of these operating divisions in order to act as a single vendor providing multiple IT solutions for our customers.

We have been in the industry for greater than 13 years and, as a result, have become one of the leading mid-size companies in the Northwest Region. Denali has been named as one of the VARBusiness Top 50 Fastest-Growing companies in the United States for the last two years, and is ranked 245th largest Value Added Reseller in the U.S.

Denali provides people, products, and processes that enable clients to increase revenue, to decrease operational costs, to achieve regulatory compliance, and improve the intangible aspects of corporate value. Our business approach ensures that business needs drive IT decisions to continue to build the overall corporate value with our customers.

Denali service offerings are strengthened through an extensive list of strategic partnerships, including BMC-Remedy, Hewlett-Packard, Microsoft, Fujitsu, SAFLink, CREDANT Technologies, Intermec, Toshiba, NEC, Cisco, Ergotron, and Trend Micro.

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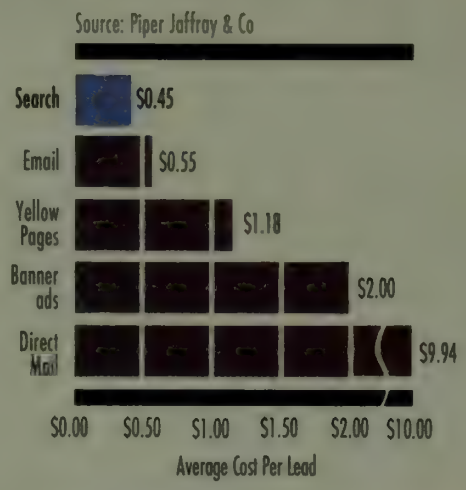
Search Engine Advertising is Essential for Modern Marketing

How do potential customers find your company? The fact that the word "Google" has emerged in modern lexicon as a verb should help you realize that most people find products or services via search engines. According to a study by DoubleClick, 41 percent of US customers used search engines to research a purchase. Only 10 percent used a print ad and 9 percent a TV ad. Are search engines directing potential customers to your products or services?

Search engine advertising is highly cost effective. A report from Piper Jaffray & Company reveals the cost per lead from search engines is $0.45. That compares to $1.18 for yellow pages advertising and $9.94 for direct mail inserts. PPC (pay per click) advertising has become the ideal marketing vehicle. You only pay a few cents per lead and those leads are highly qualified as the potential customer is actively seeking your products or services.

PPC search engine advertising expands your audience. Buying ads on Google distributes your ads on AOL, EarthLink and Ask Jeeves as well as on the main Google site. Run an ad campaign on Overture, now a Yahoo company, and your ads will be seen across MSN, Yahoo and CNN. Advertise with Google and Overture and you will reach over 90 percent of the Internet audience.

PPC advertising results can be measured. Statistics can be gathered from your web server logs to determine the efficacy of an ad campaign. For example, Analytical Investing (www.analyticalinvesting.com), an investment research service, is able to track which keywords result in new subscriptions. Knowing which keywords work saves the company money and differentiates search engine marketing from more traditional advertising. How do you know if a TV ad is working? A poorly performing search engine ad campaign can be corrected without having to build a new campaign from scratch. Try that with a print ad.



Whether your goal is to increase online sales or identify promising leads, search engine advertising is an ideal marketing platform. Consider Maine Munchies (www.mainemunchies.com) who sell gourmet specialty food gift boxes from Maine. Online sales increased 144% year over year due to search engine marketing. B2B sites that do not sell online can use keyword advertising to generate leads to pursue offline. An effective tactic to track these results involves creating an inquiry form which is only accessible when clicking on a keyword ad.

Why search engine advertising? Your customers use the search engines. Advertising on those search engines is one of the cheapest ad vehicles available. Search engine ads expand your reach to a wider audience. Your advertising results are measurable. Ads can be revised in the middle of a campaign. Perhaps the better question is this: How much of your traditional marketing budget should be shifted to search engine advertising?

To read the full report, go to
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Apogee Web Consulting LLC is a full service search engine marketing firm whose mission is to help businesses succeed on the Internet. Services available include search engine pay per click advertising campaign creation and management, comparison shopping site product inclusion and search engine optimization. All services begin with a foundation of keyword research and feature custom reporting. Products offered include open source web analytics software to track search engine traffic and a free online tool to analyze keywords used by competitors. Choose search engine marketing products and services from Apogee Web Consulting LLC. Your site. Elevated.SM

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Apogee Web Consulting LLC is a member of regional and national professional organizations including the Greater Baltimore Technology Council and the Search Engine Marketing Professional Organization. The founder, Richard Ball, is a former AOL software developer and a graduate of MIT. His search engine marketing articles are published on various industry sites including Search Engine Guide and SEO Today.

The company serves local clients in the Washington DC, Maryland, Northern Virginia area as well as clients around the country. Local clients include Hedwin Corporation, Analytical Investing, Eco-Strip and WizardsSpell. National clients include Plantrex and Maine Munchies.

Contact: Richard Ball • Founder

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In Hot Pursuit Of Yoga Mama

She's busy and choosy. But reach her, and you tap into her network of friends, too

TWO-YEAR-OLD CASANDRA King's bedroom is stocked with products that are very different from those her mother, Julia, had when she was that age. Instead of Johnson & Johnson Baby Oil and Vaseline, the Edison (N.J.) toddler gets slathered daily with petroleum-free lotions from California Baby. Her mom pays three times the price of the mass brands. And Casandra's dresser is filled with organic cotton shirts and pajamas from niche marketers such as Hanna Andersson and Mama's Earth, which can cost 50% more than clothes from Sears, where Julia's mother shopped for four kids 35 years ago.

Julia King, 38, is part of an emerging class of women whom marketers call Yoga Mamas. These middle- and upper-income mothers are more style- and brand-conscious than their parents. No matter their income, they spend like lottery winners on their babies and toddlers. In the process, they're revolutionizing the baby-products market and forcing manufacturers and retailers of all sizes to adjust.

From the start, they are focused on active, fashionable, and fit pregnancies, and then on the fitness and well-being of their offspring. They tend to be more educated and have more disposable income to spend on fewer children than past generations. As a result, the $27 billion infant and preschool products business is growing more than 4% per year, faster than the overall toy, apparel, and furniture industries. "This group is influencing other moms who have money and plenty of moms who don't," says Timothy Dowd, a senior analyst at market research firm Packaged Facts. "Yoga Mama is pumping up sales across the board."

Marketers say the evidence is in the brisk sales of premium-priced products: Burt's Bees Buttermilk lotion is $8.99 and a top seller at drugstore.com; $11.50 bu a 2 oz. jar of popular California Ba Calendula Cream at Whole Foods Marke Italian leather toddler shoes are $129 Nordstrom; Bugaboo strollers Yoga mom love for ergonomic design and brand c chet are $700 and up. And the appeal well beyond Rodeo Drive and Manhattan Upper East Side, where baby-bling-buyin includes Gund brand diamond and eme ald jewelry for newborns.

PICKLE BOTTOMS AND BUGABOOS

ALTHOUGH YOGA MAMAS may dra titters for sneaking kelp into their toddler meatballs, marketers aren't laughing their spending and influence. Mar women are starting families later in lif when they have financial footing and e tablished tastes. And there is a greater te dency among new parents to think the toddlers need the best of everything to su ceed in life. "These mothers aren't buyin baby products so much as extending the lifestyle to their babies," says Linda Mu ray, editor of www.babycenter.com.

That's why many new baby produc are designed more with mom in mind tha baby. Kids still gravitate to Winnie t Pooh, but the trendiest diaper bags a made by manufacturers such as Petun Pickle Bottom and Fleurville and cost $1 and up, eight times the cost of a Pooh b at Target. The designer bags, in patter such as houndstoo and red Asian brocad have appeared conspic ously in ABC's *Despera Housewives* and *T Oprah Winfrey Sho* And pricey strollers a justified in part becau their rugged and ligh weight design hel Mom burn calories v power walking, al "strollercizing."

Bigger spending fed by an attitudin change toward mothe hood. Superfit mother

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to-be flaunt their bulging bellies in cropped tops and low-rise jeans. "Soccer moms are passé," says author Katherine Stewart, whose recently published first novel, *The Yoga Mamas*, follows a group of fashion-obsessed mothers through spas and baby boutiques. "They are no longer content to be lunchbox-packers, and want to make motherhood a personal statement."

Like any fashion-focused industry, the new-baby business requires near-constant reinvention. Fast-growing Tiny Love, an Israeli maker of preschool playthings, launches new versions of its Gymini play mats, which feature dangling toys suspended mobile-like above the infant, flashing lights, and Mozart tunes, almost every 12 months. The latest Gymini Total Playground retails for $70, a 75% jump from the 1993 original. Oded Ben-Ezer, CEO of Tiny Love importer Maya Group Inc., expected higher-end versions to be just 20% of sales. But to his surprise, each pricier Gymini displaces the lower-priced ones. "Mothers are saying, 'I want the best for my baby.' This is a competitive world," he says.

Established industry players are scrambling to adapt. Research by Atlanta-based Carter's Inc., long the leader in baby clothes sold at department stores, showed moms want a more exclusive and convenient boutique shopping experience. So Carter's has been rolling out stores in shopping centers next to retailers like Barnes & Noble and Bed Bath & Beyond, where Yoga Mamas hang out. Carter's plans to have 250 such stores open within a few years, up from 30 now.

Even businesses that attract a much broader base of consumers are looking to Yoga Mamas as a source of growth. Booming natural foods retailer Whole Foods Markets is trying to enlarge its take of the family budget by appealing to mothers with more organic baby foods and even children's clothing made from pesticide-free hemp. Stores have held healthy eating seminars for mothers called Whole Baby. And some have added a baby registry. "A lot of women become interested in healthier living when they get pregnant," says company spokeswoman Kate Lowery.

BUGABOO'S CAMELEON It sets strollercizing moms back $879

WORD OF MEGAPHONE

YOGA MOMS' IMPACT goes beyond consumerism. Joe Trippi, campaign manager for Howard Dean's unsuccessful 2004 Presidential bid, says Yoga Mamas are in many ways a more desirable target for politicians than NASCAR Dads or Soccer Moms because they are so heavily networked—socially and technologically. When a campaign gets one as an advocate, says Trippi, it's really getting a message to dozens more. "The Yoga mom is the center of the megaphone today."

But Yoga Mamas are not easy to reach through traditional media. Whether working outside the home or not, shuttling their little ones from doctors' appointments to play dates gives them little leisure time. Web sites such as Babycenter.com and parent magazines like *Brain, Child* have climbing site traffic and circu lation. But shopping, e-mail, and chattin online are often done late in the evenin A survey of 1,800 mothers done by baby center.com on *BusinessWeek*'s beha found that 40% considere other moms among their be sources of consumer informa tion, well ahead of family an the media. Recognizing th time is of the essence to the shoppers, e-tailer babystyle.com offers tightly edited product menu of just fou or five items per category.

Still, there's a fine line between hype conscientious shopping and outrigh materialism. The babycenter.com surve showed 54% of those with household in come between $50,000 and $200,00 said they have been splurging on high end baby clothing and gear even whe bargain brands are also available. To much of that could backfire on their kid David Bredehoft, chairman of the de partment of social and behavioral sc ences at Concordia University in S Paul, Minn., has studied adul overindulged as children. Those show ered with toys, gear, and clothes later de veloped low self-esteem that manifeste itself in overeating.

"There's a treadmill of dissatisfactio that acquisition doesn't solve," says Juli B. Schor, a Boston College sociology pro fessor and author of *Born to Buy: The Com mercialized Child and the New Consum Culture*. Consider the Yoga mom wh shells out $129 for a pair of shoes for he toddler. A really sound child would hav more fun with the box they came in. ■

–By Christopher Palmeri in Los Angele with David Kiley in New Yo

PLAYBOOK: BEST-PRACTICE IDEAS

How to Catch Her Eye	WHO SHE IS	WHAT SHE BUYS	WHAT SHE CARES ABOUT	REACHING HER
	Between 25 and 45, but age isn't as big an issue as attitude. She's college-educated and either a working mom or a former career mom who opted to stay at home to raise the kids. She can be single, married, or partnered. Household income ranges from $60,000 to top 5%.	Style, design, and quality trump price, and she doesn't go for much bling. Yes to a $150 designer diaper bag. But she's apt to pass on a plasma TV or Mercedes. She chooses pricey organic food and lotions and natural-fiber baby clothes and looks for budget brands in less critical categories.	Education and child development rule her world and her baby's. Childhood obesity and the environment are concerns. She stays connected to family and friends via technology; preserves her pre-parenting passions and interests. Politically in the center.	Try www.babycenter.com, www.dot-moms.com, www.blogging-mommies.com; *Brain, Child* and *Cookie* magazines; ABC's *Extreme Makeover*; The Learning Channel; Lifetime Network. She watches lots of recorded programs and skips ads to save time.

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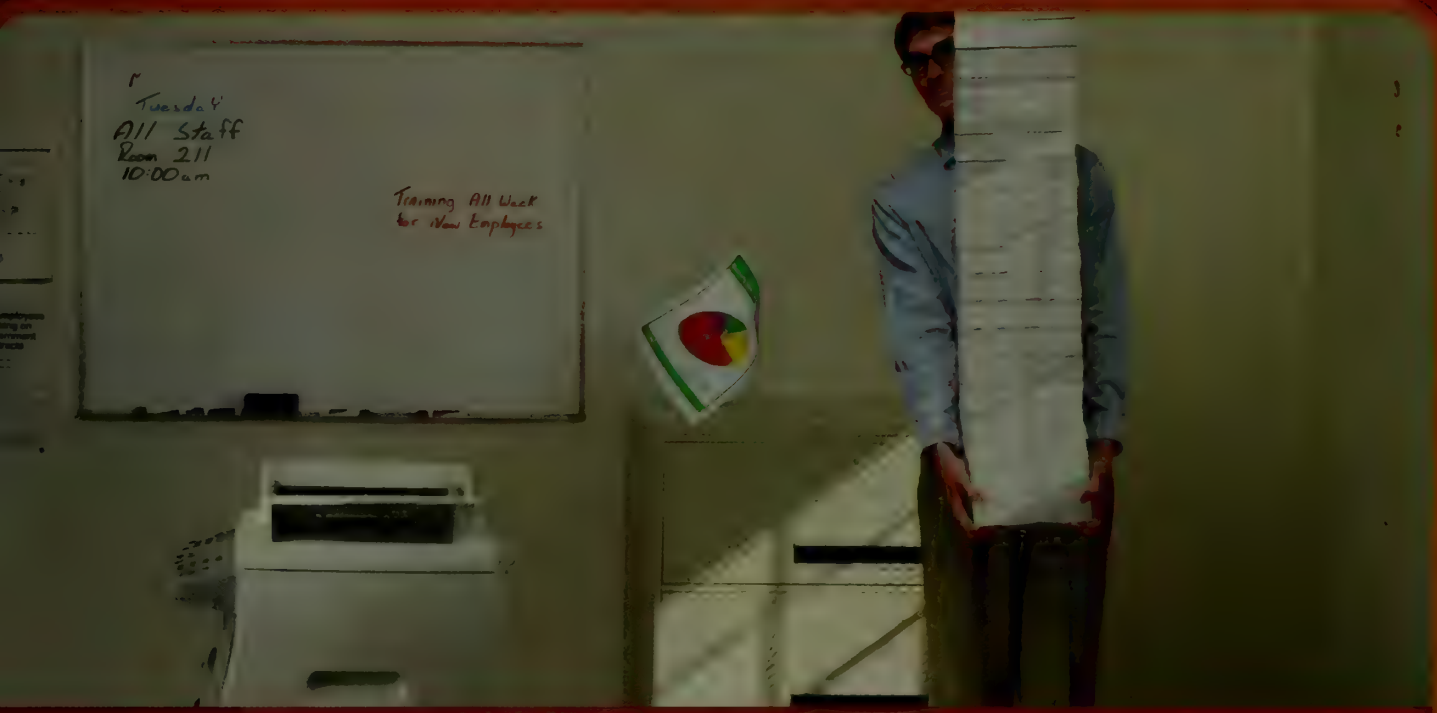

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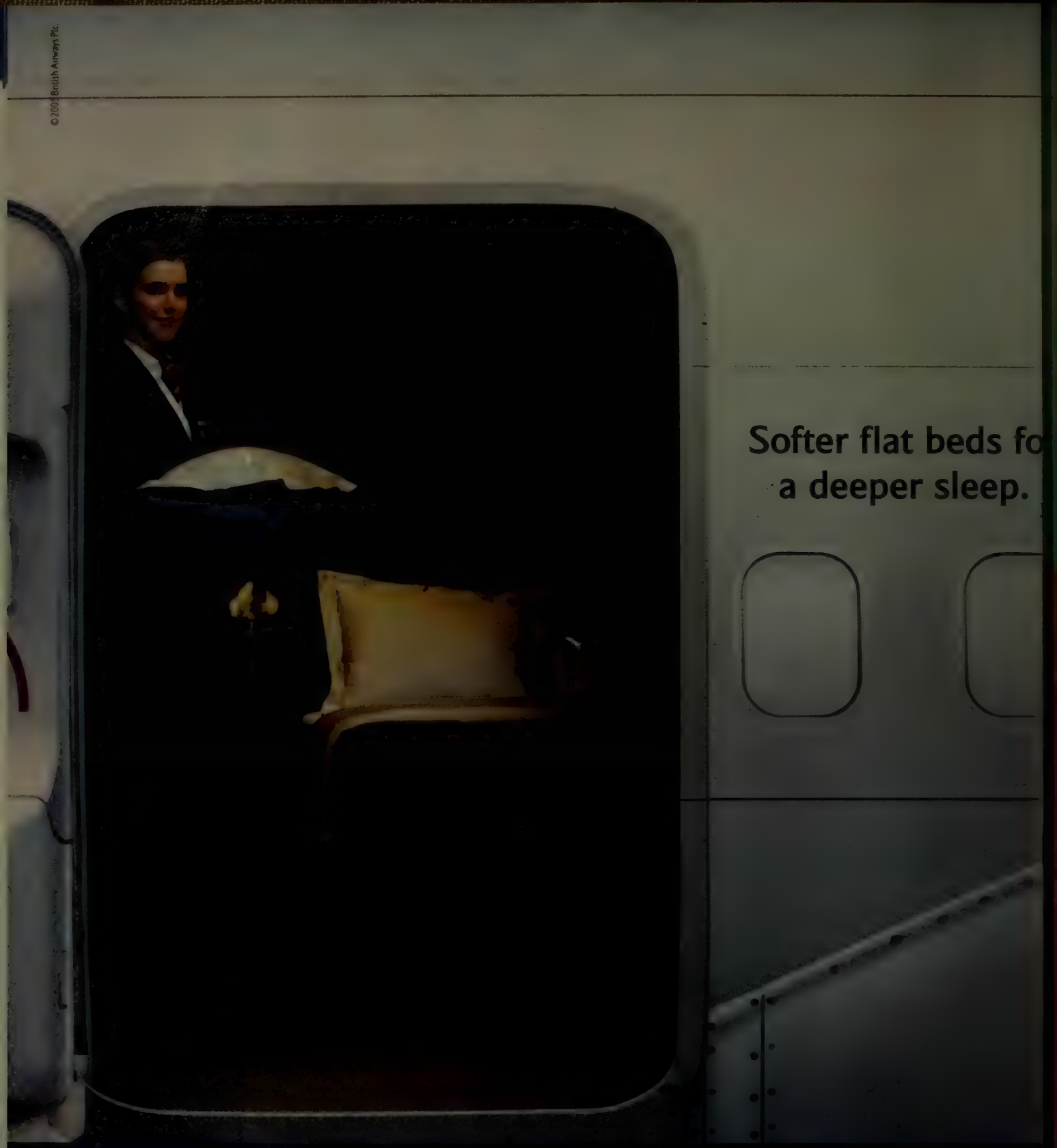

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Business traveler-oriented hotels – whether budget or luxury – are now offering as a matter of course free Wi-Fi in guest rooms and public areas (lobbies, restaurants, meeting spaces), desks with comfortable chairs, task lighting and ample (and easily reached) sockets for plugging in laptops, PDAs, and cell phone chargers.

Car rental companies offer satellite navigation systems, quick pickup and drop-off capability and, increasingly, the ability to check into a flight from the car rental return area.

Airlines, particularly international carriers, are getting much more sawy about providing products and services that allow passengers to get work done in-flight. Flying in Business Class on long-haul flights on these top carriers means more than seat-back entertainment systems and top-offs of Champagne, although road warriors don't seem to mind that one bit. On many of the progressive airlines, including British Airways and Singapore Airlines, it now means flat beds, with cushy pillows and down duvets; onboard Internet access; meals on demand, and even, in the case of Malaysia Airlines, a functional in-flight workstation.

Then there are the converged devices that help keep travelers in touch at home and office wirelessly; using all manners of gadgets and accessories. Following, we highlight some of our favorites.

Discovering the Treasures of the Gateway to China

ONE OF THE GREATEST BENEFITS OF BUSINESS TRAVEL is that it gives road warriors the opportunity to see the world. For most travelers, that's the single most gratifying aspect of life on the road. That's why the majority of trips – 60 percent, according to the YPB&R/Yankelovich Partners National Business Travel Monitor – combine some aspect of leisure travel with a business trip, either by adding a few days (or even a free afternoon) onto a trip, and/or by bringing a companion along.

For travelers to the Pacific Rim, it turns out they're not only adding time to a **Hong Kong** visit, they're visiting Hong Kong whenever they're in Asia for business. There are many reasons why. Hong Kong is the window to Asia and the gateway to China. English is spoken fluently here, along with Cantonese. And while it is a big, modern city, Hong Kong appeals to these travelers for its intriguing fusion of East and West.

Some of the world's best hotels are here too, not to mention world-class shopping (from 'ultraluxe' department stores to colorful local markets), superb dining, and festivals and other special events that draw visitors from all over the world. In sum, Hong Kong is a culturally rich, ever changing city with experiences that will be enriching for both the first time visitor and the very well traveled.

For example, the Culture & Heritage Festival (April 28–May 5) celebrates the Bun Festival and the Birthday of Lord Buddha. Enormous bamboo towers studded with edible white Chinese buns, are part of a week-long celebration, whose grand finale is marked by a colorful street procession of costumed children on stilts. The Birthday of Lord Buddha is a celebration of great reverence in Hong Kong's Buddhist temples and monasteries; Po Lin Monastery on Lantau Island, home to the world's largest, seated, outdoor bronze Buddha, will be the hub of the activity.

Next year is particularly apt for a visit to Hong Kong. 2006 has been designated "Discover Hong Kong Year." Twenty-two hotels and a new convention facility have opened this year, and many new attractions and activities have been planned throughout Hong Kong Island, Kowloon, the New Territories and the more than 200 islands that make up the destination.

To find out more, visit www.DiscoverHongKong.com/usa and/or download the *Leisure Guide for Business Travelers* to your PDA.

• *Want to check into your international flight before you leave for the airport?* **British Airways** is the first global airline to offer online boarding pass capability on nonstop international flights from all of its U.S. gateways. That means London-bound passengers can choose their own seat and print their own boarding passes when checking in online – beginning 23 hours before departure.

The Online Boarding Pass, with a passenger-specific barcode, enables flyers with hand baggage to bypass conventional check-in desks and go straight to the security area. Passengers with luggage to check also print their boarding passes online and then use the British Airways Fast Bag Drop facility near the airline's check-in counters to check their bags.

The service is the latest of several British Airways has introduced to simplify the planning and booking process. At the airline's Web site, the popular 'manage my booking' section has been revamped to offer customized, relevant travel advice to passengers. The 'checklist' option, for example, enables customers to view a handy point-by-point list of tasks that will help ensure their trip goes smoothly. With a few clicks, they'll find the quickest and easiest way to check-in for their flight; passport and visa information, including whether they're required to enter Advance Passenger Information before they travel. There also are city guides covering the destination being visited. For information: www.ba.com

• *Need to work on your flight?* **Bose QuietComfort® 2** noise-cancellation headphones will block out the drone of jet engines and a gabby seatmate; they also enhance the audio quality of an iPod even when ambient noise isn't an issue. For info www.bose.com

• *Need an office or a meeting room whe you're far away from your own?* **Regus**, the world's largest provider of temporary office space, meeting rooms and videocon ferencing studios, offers facilities in roughl 400 prime locations in 220 cities in 50 countries, in central business districts, offic parks, or locations adjacent to airports. Every Regus center provides meeting room supported by high-tech audiovisual equipment, catering, telephones, and high-spee Internet access. For info: www.regus.com

Travel Managers Drive Value with Online Booking

In a recent survey of travel managers by the **National Business Travel Association (NBTA)**, 70 percent of respondents said that their companies use online booking tools, and another 24 percent indicated plans to implement online booking in the future.

These tools provide an interface similar to what many business travelers experience when they purchase personal travel online, and they give the company's travel department a mechanism for driving additional value. With online booking, travel managers can reduce transaction fees, and cut out-of-policy spending by loading the company's travel policies and setting up automated procedures for pre-trip approval.

For more corporate travel management information, visit www.nbta.org.

2006 DISCOVER HONG KONG YEAR

Free Leisure Guide for Business Travellers

Enjoy it!

Mix business with pleasure in Hong Kong.

2006 DISCOVER HONG KONG YEAR

HONG KONG. LIVE IT. LOVE IT!

Whether your business trip allows you three extra hours or three extra days, you'll love discovering Hong Kong's authentic cultural experiences, hidden gems and new attractions during 2006 Discover Hong Kong Year. A great way to relax and recharge is on the Ngong Ping 360* journey of enlightenment with its panoramic vistas, timeless cultural village, stately giant Buddha and meditative Wisdom Path. What's more, Hong Kong's a snap to get around. So, it's easy to uncover the city's heritage at festivals and museums, hone your bargaining skills at colorful outdoor markets or entertain clients at authentic, gourmet restaurants and hip nightclubs. With so much to see and do in Hong Kong, you'll be tempted to extend your stay, bring a companion along or even make a special trip here if you're doing business elsewhere in Asia.

For more information about Hong Kong, visit www.DiscoverHongKong.com/usa.

*Ngongping 360 will open in early 2006

Free Hong Kong Leisure Guide for Business Travellers! This [illegible] guide helps you make the most of your time in Hong Kong with tips on the city's best dining, entertainment, sightseeing, shopping and more. For your free copy, e-mail us with your complete name and address to laxwwo@hktb.com. Or for a PDA-downloadable version, visit **www.DiscoverHongKong.com/usa** and click on "Meeting Your Needs."

HONG KONG TOURISM BOARD

HONG KONG

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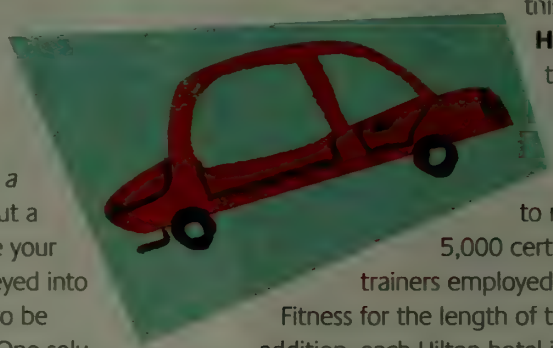
How to Use Down Time at Airports

- **Catch up on e-mails. Many airports have free Wi-Fi service in waiting areas. Failing that, find a Laptop Lane (www.wayport.net) business center for a private workstation.**
- **Play golf. Some major airport hotels have one or more 18-hole golf courses within a few minutes of the terminals. Check out Hyatt Bear Creek at D/FW Airport. It has two18-hole courses and club rentals.**
- **Do personal errands. Get a shoeshine, haircut, or manicure. Buy stamps; mail the materials gathered on your business trip to your office instead of lugging everything to your next stop.**
- **Nail down the details of your business trip. Boston's Logan Airport has a concierge who functions the same way as your typical upscale hotel major domo. Other airports with concierges: New York's JFK and Atlanta's Hartsfield.**

• *Need a quiet place to work while you're at the airport, and you don't belong to an airline's VIP club?* **Priority Pass**, best known for its hotel rewards, bills itself as the world's largest independent airport VIP lounge access program. For a modest annual fee, you'll get access to 450 lounges in 245 cities in 80 countries, regardless of which carrier you're flying or the class of your ticket. For info: www.prioritypass.com



• *Taking notes during a meeting is essential*, but a bit of a nuisance, since your scribbles have to be keyed into a computer if they're to be stored and/or shared. One solution is a **Hewlett-Packard Tablet PC**. Another is the digital pen. The **Logitech io$_2$**, looks, weighs and feels like a premium pen; it has an ink cartridge so you can see what you're jotting. And while you write, a tiny camera with an optical sensor captures your work and registers the pen's movements, while a processor digitizes your words and images. After placing the pen in its cradle, all your information gets transferred to your PC or onto a network server. For info: www.hp.com, www.logitech.com

• *Traveling abroad sans laptop and don't want to rely on Internet cafes to access e-mail?* **Roadpost** offers a Blackberry rental program designed for the occasional international traveler. Roadpost Blackberry Mail allows users to access unlimited roaming data services from 70 countries and have e-mails forwarded and received through their regular e-mail address while traveling. (Travelers can also opt to use an assigned e-mail address just for their trip.) The service includes unlimited data (meaning no megabyte charges.) For info: www.roadpost.com

• *Want to work out, but don't have the time or wherewithal to find a personal trainer in a city you don't know?* Earlier this year, **Hilton Hotels** launched the Personal Trainer Program, which gives guests access to more than 5,000 certified personal trainers employed by Bally Total Fitness for the length of their stay. In addition, each Hilton hotel is now equipped with "Travel Fit Kits," mobile in-room gyms developed by Bally's head of personal trainers. The kits can be checked out free of charge at the Front Desk, and include pairs of 3- and 5-pound dumbbells, resistant tubes for upper body conditioning, elastic bands for leg exercises, a yoga mat, and a booklet with suggestions for an in-room workout. If you'd rather stick to cardio only, many Hilton properties will also deliver a treadmill directly to the guest room for $15.95 per day. For info: www.hilton.com

• *Stuck at an airport on a layover and in dire need of a snooze?* **MetroNaps**, which made a splash when it opened its first "power napping" center in the Empire State Building, has expanded to airports. Vancouver International Airport (YVR) has installed three of the company's cushy "pods," where the travel weary can drift off to the sounds of nature, delivered via Bose noise-cancellation headphones and then be gently awakened by vibrations. For info: www.metronaps.com

• *Driving around in an unfamiliar city has just gotten a lot easier* with the **Garmin nüvi**, a handy device that incorporates global positioning system (GPS) technology into a portable, user-friendly gadget about the size of a deck of cards. With it, you get detailed maps, turn-by-turn voice directions and automatic routing; there's also a text and spoken-language translator for nine languages, an international currency converter, a world clock, a built-in MP3 player and a JPEG picture viewer. For info: www.garmin.com

• *Tired of lugging a laptop around from meeting to meeting?* The new **Panasonic Toughbook-W2** weighs less than three pounds, and is built to handle the rough-and-tumble world (cramped luggage compartments, X-ray machines, careless bellhops) of the road warrior. The computer is also thin enough to fit easily into a briefcase – at its thickest point it's two inches, at its thinnest, only one. Besides its shock-absorbing capability, The Toughbook has a heroic battery, which can run for six hours between recharges. For info: www.panasonic.com

• *A picture is worth a lot more than 1,000 words* if it can seal a deal or make a trip to a trade show more productive than usual. That's why the **Veo Mobile Connect** Web camera is such an interesting concept for the business traveler. The device clips onto a laptop and plugs into a USB port, letting you record video or still images and send them back to the office. For info: www.veo.com

WEB RESOURCES

British Airways
http://www.ba.com

Hong Kong Tourism Board
http://www.DiscoverHongKong.com/usa

National Business Travel Association
http://www.nbta.org

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BY GENE G. MARCIAL

UNCERTAINTY OVER AN ASBESTOS BILL CLOUDS USG'S FUTURE.

ADVANTA'S CREDIT-CARD BUSINESS MAY ATTRACT A BUYOUT.

WHY SOUTHWEST AIRLINES LOOKS POISED FOR TAKEOFF.

Writing on USG's Wall?

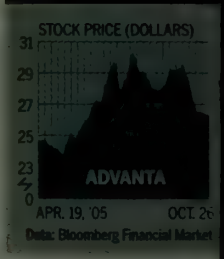
IS TIME RUNNING OUT FOR USG (USG)? Shares in the No. 1 maker of gypsum wallboard got hammered in early October, falling from 70 to 58 in two weeks as fears about asbestos liabilities resurged. By Oct. 25, when USG posted good third-quarter earnings, the stock had edged up to 60. But asbestos still haunts the company. "There is substantial risk in USG shares, which could depreciate by more than 50% [in the absence of asbestos litigation reform]," says Jim Barrett of investment firm CL King. In June, 2001, USG filed for Chapter 11 because of asbestos litigation at its U.S. Gypsum unit. What may save USG is Senate Bill 852, creating a $150 billion trust fund to pay asbestos victims over 30 years. But opposition from some members of Congress and private groups have postponed its submission on the Senate floor till early 2006. USG and the Asbestos Alliance, comprising 57 CEOs, have urged the Senate to act promptly. But whether the bill will pass is "too tough to call," says Barrett. Matt Kibbe, president of FreedomWorks, a free-market advocate, believes "the asbestos bill is virtually dead [because] both Republicans and Democrats oppose this huge bailout." The big question is USG's liabilities: Asbestos lawyers claim it is $5.5 billion, vs. USG's asbestos reserves of $1.06 billion. In its 2004 annual report, USG warns that risks "remain great" and that investments could be "diluted or even wiped out." Excluding asbestos, Barrett sees USG earning $9.82 a share in 2005 and $11 in 2006. Tom O'Brien, chairman of the Coalition for Asbestos Reform, which is opposing the bill on behalf of small and midsize businesses, says the fund has a "highly uncertain revenue stream" and will be short by $160 billion—and "broke in three years." *Value Line*'s Craig Sirois says "the issue is too risky," so investors should take profits.

A TUMBLE MAY LIE AHEAD

Hungry Banks Are Eyeing Advanta

AFTER BANK OF AMERICA acquired credit-card lender MBNA in mid-July, other banks started looking for acquisitions. One target: Advanta (ADVNB), No. 3 in small-business credit cards, whose stock rose from 28 to 31 after the MBNA deal. Advanta, now at 26, is worth 33 to 35 in a buyout, says one New York hedge-fund pro close to one of two banks eyeing Advanta. He did not want to be named. Advanta declined comment. CEO Dennis Alter and family control 40% of the A voting shares. Citigroup tops the Visa-MasterCard market for small business, with a 20% share. Wells Fargo has 17%; Advanta 14%. Scott Valentin of Friedman, Billings, Ramsey rates Advanta "outperform." Should it become a takeover target, "we would value it in the low-to-mid 30s," he says. After a strong third quarter, he raised his 2006 earning estimate by 9¢, to $2.25 a share. His 2005 estimate stays at $1.93.

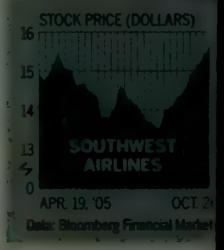
CHARGING UP



Southwest Airlines Wings North

WHEN SOUTHWEST AIRLINES (LUV) skidded to a 5 week low of 13.14 on Sept. 1, Kevin Lane of Redwood/Technimentals Research pulled the "buy" trigger. Airlines have been out of favor on the Street, but Lan was sure his reading was correct: Southwest would pull up c technical and fundamental reasons. On Oct. 21, Southwest posted better-than-expected third-quarter earnings despite rising fuel prices, boosting the stock to 15.80. Andrew Light of Citigroup Global Markets, which owns shares and has done banking for Southwest, raised his earnings forecast for 2005 from 59¢ to 60¢ a share and for 2006 from 49¢ to 58¢, rating the airline a buy. Joseph Phillips of Redwood says it is the most profitable of the airlines. Its balance sheet is spotless, with a low debt-to-capital ratio and a high operatin margin of 14%. Substantial portions of its fuel costs are hedged as far out as 2009, he notes. As a low-cost carrier, Southwest's business model works, says Phillips. In 6 to 12 months, he sees the stock flying to 22. ■

HIGHER ALTITUDE



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investmen banking or other financial relationships with them.

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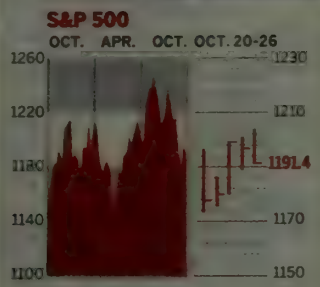
Personal Business Figures of the Week

STOCKS



COMMENTARY

George Bush's pick of Ben Bernanke to succeed Alan Greenspan overshadowed good earnings from Boeing and AmEx and spectacular results from Google. While the Street cheered, some of the rise in stocks was a bounceback from options and futures contract expirations. Not everyone is pleased: Bernanke has little street cred in the bond market and none with gold bugs.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	OCT. 26	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1191.4	−0.4	−1.7	7.2
Dow Jones Industrials	10,345.0	−0.7	−4.1	4.6
NASDAQ Composite	2100.1	0.4	−3.5	8.5
S&P MidCap 400	590.4	0.8	4.1	16.5
S&P SmallCap 600	334.5	−0.3	1.7	13.8
DJ Wilshire 5000	11,889.5	−0.2	−0.5	9.2
SECTORS				
BusinessWeek 50*	717.2	−0.5	1.8	10.7
BW Info Tech 100**	359.4	0.4	−3.7	8.0
S&P/BARRA Growth	571.5	−0.8	−1.8	6.7
S&P/BARRA Value	615.7	0.1	−1.6	7.8
S&P Energy	363.2	0.6	25.8	28.1
S&P Financials	401.7	1.4	−2.3	6.6
S&P REIT	145.7	0.3	0.9	9.4
S&P Transportation	227.7	1.7	−5.7	3.7
S&P Utilities	156.1	0.0	10.2	10.6
GSTI Internet	181.4	0.9	1.7	18.3
PSE Technology	795.8	0.2	2.1	15.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	OCT. 26	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MONTH
S&P Euro Plus (U.S. Dollar)	1419.7	2.0	1.6	16
London (FT-SE 100)	5227.8	1.2	8.6	[illegible]
Paris (CAC 40)	4412.7	0.9	15.5	21
Frankfurt (DAX)	4900.8	1.1	15.1	26
Tokyo (NIKKEI 225)	13,395.0	2.0	16.8	25
Hong Kong (Hang Seng)	14,458.1	0.6	1.6	12
Toronto (S&P/TSX Composite)	10,293.7	−1.4	11.2	1[illegible]
Mexico City (IPC)	15,666.2	3.7	21.3	5[illegible]

FUNDAMENTALS	OCT. 25	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.09%	2.12%	1.72
S&P 500 P/E Ratio (Trailing 12 mos.)	18.1	18.1	19.1
S&P 500 P/E Ratio (Next 12 mos.)*	14.1	13.9	15.5
First Call Earnings Surprise*	1.60%	2.74%	2.18

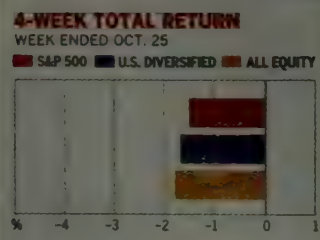
*First Call C

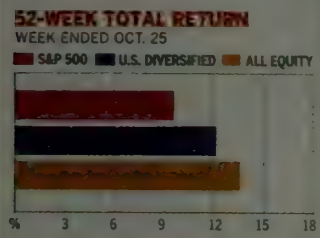
TECHNICAL INDICATORS	OCT. 25	WEEK AGO	READ
S&P 500 200-day average	1199.1	1199.0	Negati
Stocks above 200-day average	49.0%	44.0%	Neutr
Options: Put/call ratio	0.82	0.98	Positi
Insiders: Vickers NYSE Sell/buy ratio	3.52	3.77	Negati

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Internet Software	10.2	Oil & Gas Refining	92.1
Airlines	8.0	Managed Health Care	69.6
Metal & Glass Containers	7.1	Health-Care Distrbtrs.	60.3
Air Freight & Couriers	7.1	Tobacco	52.2
Hypermkts. & Suprcntrs.	6.4	Oil & Gas Exploration	48.2

WORST-PERFORMING GROUPS	LAST MONTH %		LAST MONTH
IT Consulting	−22.2	IT Consulting	−50
Photographic Products	−15.0	Home Furnishings	−30
Tires & Rubber	−13.5	Automobiles	−29
Integrated Oil & Gas	−11.9	Photographic Products	−2[illegible]
Building Products	−11.7	Aluminum	−27

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES: 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Financial	0.6	Latin America	62.3
Japan	0.2	Natural Resources	37.1
Technology	−0.1	Diversified Emerg. Mkts.	33.2
Large-cap Growth	−0.5	Diversified Pacific/Asia	24.7
LAGGARDS		**LAGGARDS**	
Natural Resources	−6.4	Precious Metals	5.3
Diversified Emerg. Mkts.	−5.0	Domestic Hybrid	7.2
Utilities	−4.9	Miscellaneous	9.0
Pacific/Asia ex-Japan	−4.8	Financial	9.0

EQUITY FUNDS: 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Berkshire Focus	6.5	T. Rowe Price Lat. Am.	67.8
ProFunds Internet Inv.	6.2	iShares MSCI Brazil Idx.	67.3
Rydex Transportation Inv.	4.8	iShares S&P L. Am. 40 Idx.	67.1
Forward Emerald Tech. A	4.7	Merrill Lynch Lat. Am. C	63.3
LAGGARDS		**LAGGARDS**	
Ameritor Investment	−18.2	Ameritor Investment	−60.9
American Heritage Grth.	−16.7	American Heritage Grth.	−28.6
ProFunds Oil & Gas Inv.	−13.7	ProFds. USh. Mid Cap Inv.	−28.1
U.S. Glbl. Accde. E. Erpn.	−9.5	ProFds. USh. Sm. Cap Inv.	−22.2

INTEREST RATES

KEY RATES	OCT. 26	WEEK AGO	YEAR AGO
Money Market Funds	3.34%	3.31%	1.30
90-Day Treasury Bills	3.89	3.85	1.91
2-Year Treasury Notes	4.35	4.24	2.53
10-Year Treasury Notes	4.58	4.46	4.00
30-Year Treasury Bonds	4.78	4.69	4.77
30-Year Fixed Mortgage †	6.12	6.06	5.64

†BanxQuote, I

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.89%	4.54
Taxable Equivalent	5.56	6.49
Insured Revenue Bonds	3.97	4.61
Taxable Equivalent	5.67	6.59

THE WEEK AHEAD

PERSONAL INCOME *Monday, Oct. 31, 8:30 a.m. EST* » September personal income is forecast to have risen 0.4%, after slipping 0.1% in August. That's the consensus estimate of economists surveyed by Action Economics. Consumer spending most likely rose 0.5%, after a fall of 0.5%.

FOMC MEETING *Tuesday, Nov. 1, 9 a.m. EST* » The Federal Reserve's Open Market Committee meets to set monetary policy. The universal expectation is that the central bank will hike the Fed funds rate by a quarter-point, to 4%.

PURCHASING MANAGERS' INDEX *Tuesday, Nov. 1, 10 a.m. EST* » The Institute for Supply Management's October factory activity index probably eased to 57.3%. The September index made an unexpected jump to 59.4%.

PRODUCTIVITY & COSTS *Thursday, Nov. 3, 8:30 a.m. EST* » Output per hour worked very likely edged up to a 2% annual rate in the third quarter, after a 1.8% rise in the prior period. Unit labor costs probably grew 2.3%, following a first-quarter gain of 2.5%.

EMPLOYMENT *Friday, Nov. 4, 8:30 a.m. EST* » October nonfarm payrolls most likely grew by 120,000, after hurricanes led to a reported decline of 35,000 jobs in September. A rebound in jobs is not expected to lower the jobless rate of 5.1%.

The BusinessWeek production inde edged down to 257.3 for the wee ended Oct. 15, 12.4% above the yea ago level. Before calculation of th four-week moving average, the ind also stood at 257.3.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.

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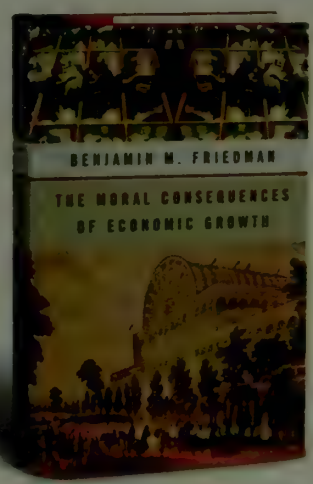
What's So Good About Growth

THE MORAL CONSEQUENCES OF ECONOMIC GROWTH
By Benjamin M. Friedman; Knopf; 592pp; $35

The title of Harvard University economist Benjamin M. Friedman's new book, *The Moral Consequences of Economic Growth*, might seem a bit off-key. After all, politicians and economists typically focus on the material benefits of growth—more and better jobs, higher gross domestic product, larger incomes, and more money available for government programs. And companies such as Wal-Mart Stores Inc. typically point to economic benefits, such as low prices for consumers and jobs for workers, when they want to justify their business policies.

But the narrowness of the public discussion is exactly what Friedman wants to address. "Our conventional thinking about economic growth fails to reflect the breadth of what growth, or its absence, means for a society," he writes. "Growth is valuable not only for our material improvement but also for how it affects our social attitudes and our political institutions—in other words, our society's *moral* character."



The real benefit of growth, Friedman argues, is that it encourages a wide range of social virtues, including dedication to democracy, tolerance of diversity, social mobility, and commitment to fairness. By contrast, he writes, "when living standards stagnate or decline, most societies make little if any progress toward any of these goals, and in all too many instances they plainly retrogress."

The book, at almost 600 pages, is too long and quite repetitive in spots. And it doesn't pack the punch of Friedman's influential 1988 book, *Day of Reckoning: The Consequences of American Economic Policy Under Reagan and After*, which warned that massive budget deficits were going to badly damage the U.S. economy.

But in this book Friedman has scored a dead-center hit on the critical question: Why do we value economic growth? The usual argument is that a bigger GDP—more goods and services—leads to happier, more satisfied citizens. But that apparently simple proposition turns out to be far more complicated. As Friedman notes, there is plenty of evidence that people judge their well-being by comparing themselves to others. As the average income in a country goes up, so do expectations. As a result, the level of GDP per person in a country, taken alone, doesn't necessarily say much about the level of happiness.

The lack of a direct link between personal satisfaction and the level of GDP per person seems to undercut the purely economic arguments in favor of growth. After all, why shou we undergo all the turmoil of technological change and economic restructuring if more gadgets and bigger homes aren't going to make us happier in the end?

Friedman argues that economic growth has a key additior benefit: As long as people see their own income rising, they worry less about doing better than others. And that in turn creates a more favorable environment for political and social advances. To demonstrate this point, he draws on economic studies and historical examples, both American and global. I the 1700s, he points out, it became accepted that the rise of commercial and trading activity was a force for positive legal and institutional change. Adam Smith, for one, believed that moral progress went hand in hand with economic progress, voluntary exchange replaced the use of force.

Friedman points to the the Ku Klux Klan in the U.S. and the Nazis in Germany as example of what can happen when growth vanishes. Ar he worries that "rising intolerance and incivili and the eroding generosity and openness . . . ha been, in significant part, a consequence of the stagnation of American middle class living standards during much of the last quarter of t twentieth century."

Friedman is forthright about admitting tha the New Deal doesn't fit his argument. He says the hard times of the Great Depression brough forth a virtue: a generous public response. Bu the New Deal was "exceptional," says Friedma arguing that rising incomes in general make people more willing to help others.

Economic gains, writes Friedman, are crucial for any social advance

The link between economic growth and democracy also works on a global level. The movement toward civil liberti and open societies, says Friedman, has been most successful in countries with rising incomes: He predicts China will take this same path

This is not a politically biased book—you would have hard time telling from it whether Friedman is a Republican or a Democrat. But it does provide a new framework and language for discussin economic growth, one that's useful for economists, politicians, and business leaders alike. The goal is not simply more, but more moral. ■

–By Michael Manc

BusinessWeek online For more discussion about growth and posts on other topics, read Mandel's blog at businessweek.com/the_thread/economicsunbound

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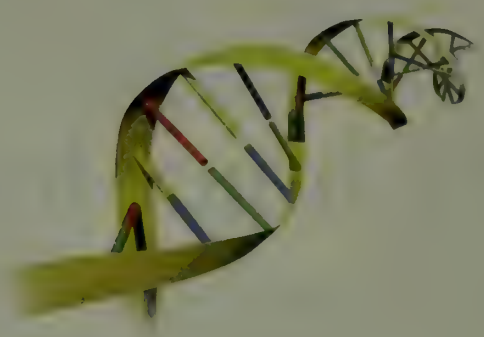

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IdeasViewpoint

BY ROBERT J. BARRO

The Right Choice for the Fed

President George W. Bush has likely just made his most important appointment, that of Ben S. Bernanke to succeed retiring Federal Reserve Chairman Alan Greenspan. I think Bernanke is an excellent choice becaus he combines a deep understanding of monetary theory with broad policy experience. The next Fed chair will need both traits to maintain the board' record of low inflation and to deal with future financial crises.

The triumph over inflation in the last 25 years has been one of the great successes of economic policy. Back in 1980-81, the broad inflation rate exceeded 10%. Fed Chair Paul A. Volcker, backed by President Ronald Reagan, committed to using contractionary monetary policy to bring inflation down. The main instrument was high interest rates: Volcker boosted the federal funds rate to a dizzying 19% in 1981, and held fast to high rates despite the 1981-82 recession. This policy proved remarkably successful, and inflation receded to 3% by 1983. Most important, the Fed established a strong reputation for raising rates when inflation threatened and lowering rates only when inflation was tame.

IN ADDITION TO RESPONDING to inflation, the Fed tends to raise rates when the economy is strong and lower them in weak spells. It does this not in reaction to overall growth but rather to the labor market; rates rise when employment growth is high and the unemployment rate is low. But unlike the central bank's necessary response to inflation, it is unclear whether this part of Fed policy is useful.

The Fed was a monetary policy innovator in the 1980s, but many other central banks have since surpassed it in the use of sophisticated techniques. Beginning with New Zealand in 1989, a number of central banks successfully designed and followed formal rules for inflation targeting. Examples include Canada, Britain, Australia, and Sweden. The less formal U.S. procedure shares some features of these rules, notably the tendency to raise rates when inflation is high. However, despite increases in transparency, the U.S. system remains opaque and relies more on the judgment and credibility of its chair—since 1987, Greenspan.

The occasion of a new chairman is a good time to consider a shift to a more formalized procedure, particularly since credibility will be more of an issue when the office holder is no longer a policy icon. Thus it is fortunate that Bernanke, well schooled in policy through his position as chair of the White House's Council of Economic Advisers and previous stint on the Fed's Board of Governors, is also one of the mai contributors to research on inflation targeting.

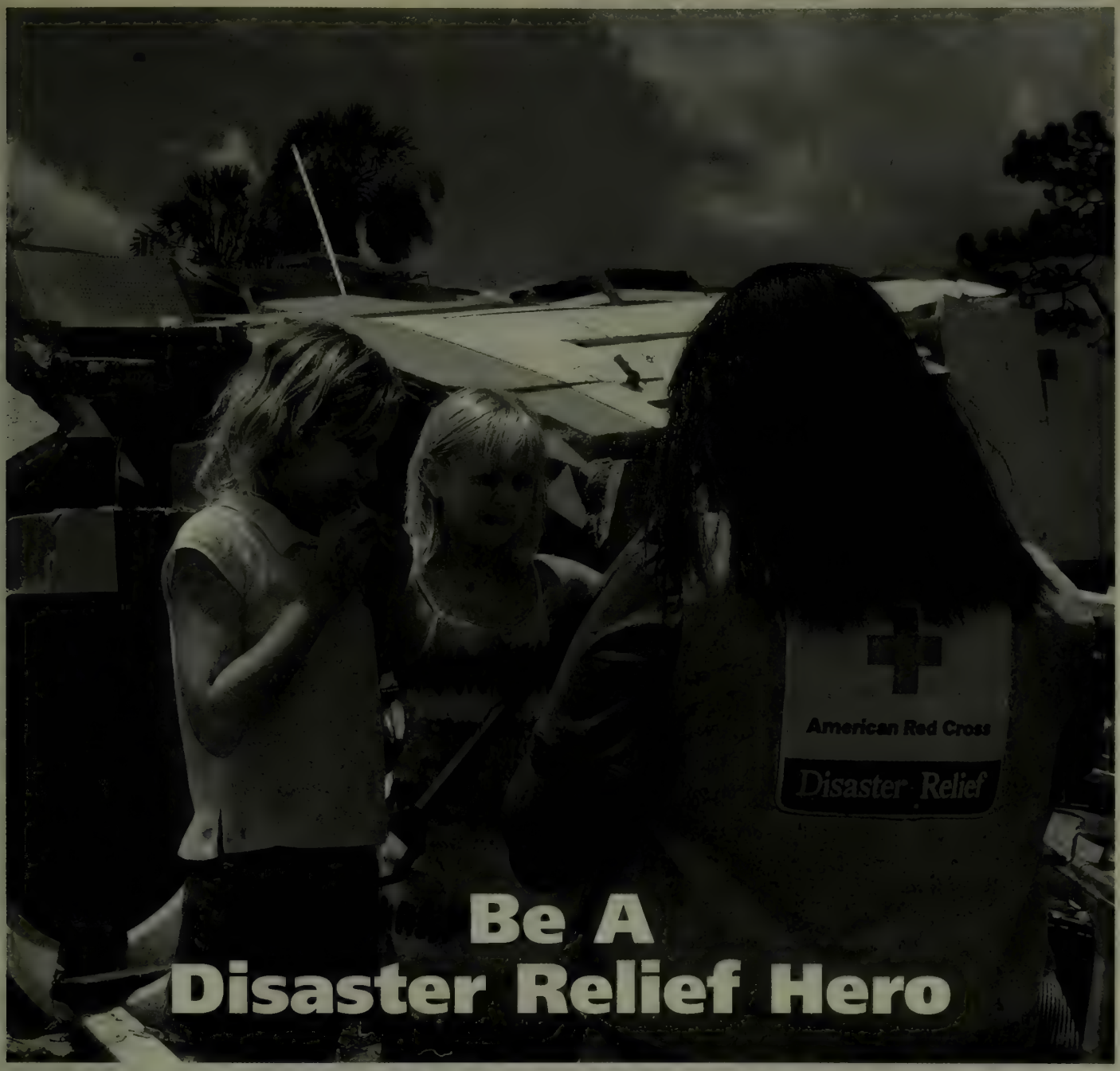
A crucial question is how Bernanke would function in a global crisis—specifically, whether he could maintain the con fidence of U.S. and world financial markets. Although I lack i side information on this trait, I can offer a firsthand account Bernanke's performance during a more localized predicamen Back in 1983, only four years after receiving his PhD in econ mics from the Massachusetts Institute of Technology, Bernan gave a seminar at the University of Chicago's prestigious Money & Banking Workshop, founded by Milton Friedman. The workshop that year was headed by economist Robert Lucas, and I was second-in-command. Althoug Lucas was 12 years away from his Nobel prize, everyone knew that he would get one eventuall and he had an almost godlike reputation.

> Bernanke, an expert on inflation targeting, is likely to keep a cool head in a crisis

I was seated next to Lucas during that seminar and noticed that he was mumbling in an increasingly annoyed manner every time a seminar participant—an equally brilliant economist Lucas could never stomach—interjected. Finally, Lucas stood up, exclaiming for all to hear "I can't take this any more," and stormed out. Due to my proximity, only I realiz that he was reacting to the other economist wh so vexed him. Everyone else—including Bernanke—thought the revered Lucas was responding with disgust to Bernanke and his paper. Most senior professors would have broken down, but not the young Bernanke. He continued without pause and completed the 90-minute seminar with aplomb. Only at the end did he coolly ask: "What's up with Bob?"

I know that this incident was only an academic seminar, but I think that the coolness Bernanke showed under this Chicago fire has only increased over the years. So, I was greatly pleased that Bush chose him to be Fed chair. Sometimes even Washington makes the right choice. ■

Robert J. Barro *is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).*



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The Perils of Unskilled Labor

FOR YEARS, AMERICAN workers have grown increasingly angry over the exodus of U.S. jobs to fast-industrializing India. Think auto parts manufacturing, call centers, computer help desks, or software programming jobs. So it's not without a bit of irony that we note this week that employers on the Indian subcontinent—many of whom have built their business models on offering lower-cost labor to Western companies—are now experiencing labor shortages that are pushing their own wages up (page 54).

It seems that all the foreign demand for India's bargain-priced manufacturing and high-tech labor—plus a boom in construction and consumer services jobs sparked by India's heady internal growth—has left skilled workers at a premium across the subcontinent. Wages for some semi-skilled textile factory workers have jumped 10% this year, while supervisors' salaries have risen by 20%. And overall Indian salaries will rise 12.3% this year, Mercer Human Resource Consulting figures, more than double the nation's inflation rate.

While many U.S. workers might view this as a fitting comeuppance for Indian industry, that would be wrong for several reasons. The developed nations look increasingly to the Third World to provide them with ever-cheaper items to maintain high living standards. Call that the Wal-Mart effec But too-rapid wage inflation in developing countries puts th symbiotic relationship at risk. Likewise, rising wages could fuel general inflation in India, slowing its economic growth and making Indian companies less able to buy high-value goods and services sold by First World companies. That eventuall hurts Western workers as well.

India's shortage of well-trained workers may hamper its growth

The real problem for India isn' a lack of workers. In a nation where the population has tipped 1 billion, there's no shortage of warm bodies. Instead, India's ability to train new workers can't keep pace with its rapidly expanding economy's demand fo manpower. For example, India's world-class elite universities boa fewer than 100,000 graduates each year. But its high schools graduate about 14 million students annually—so nearly all go on to lesser universities trade schools providing training beneath global standards.

The lesson here is that education, training, and developme of intellectual infrastructure are every bit as important as low wages for today's global trading powers. (China recognized th early on; Mexico didn't.) Interestingly, that same message als offers hope for the more mature economies (and expensive workforces) of the U.S. and Europe. Continued investment in human capital may be their best hope to remain truly competitive in a world full of faster-growing, low-wage competitors. As India's current predicament shows, wages matter—but skilled workers matter more.

What Business Owes Rosa Parks

ALTHOUGH SHE NEVER earned an MBA or worked for a big corporation, Rosa Parks, the civil rights pioneer who died at age 92 this week, had a surprisingly large impact on American business. Parks made history in 1955 by refusing to give up her seat on a Montgomery (Ala.) bus to a white man, triggering a movement that eventually led to the end of legalized racial segregation in the U.S. That allowed America over the next 50 years to begin utilizing the talents of all its human capital—including the millions of black Americans brought into the social and economic mainstream by Parks's quiet act of defiance.

The consequence of her activism has particular resonance for business, long a champion of meritocracy. Parks pursued an America where people can rise—and fall—on the strengt of hard work and merit, regardless of how different they are from the majority. If that sounds familiar, it's because it's th American dream that has inspired outsiders from the Pilgrims in the 1600s to Jews fleeing Nazi oppression in the 1930s to today's flood of Mexican immigrants. That same dream has made the U.S. the envy of much of the world—an the scourge of repressive elites that would rather keep powe and privilege reserved for the few. And it has fostered our unique business climate where the best and brightest of eve creed or color come to succeed.

Today's more-inclusive environment wouldn't have been possible without Parks's challenge to America's whites-only traditions. And we would not have the likes of today's black CE at American Express and Time Warner, or black presidents at Oracle and Sears Holdings. (You see, those confined to the bac of the bus would never make it to the boardroom.)

America is certainly not yet the Promised Land for Africa Americans: Educational levels remain low, median househo income is 32% below that of whites, and blacks' share of management and professional jobs remains far beneath the percentage of the population. But the nation has come a lon way in the half-century since Ms. Parks took her bold stand staying seated. To deny that—or to ignore how much furthe America has yet to go—is to forget her powerful legacy.

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How the Swedish retailer became a global cult brand

BY KERRY CAPELL (P. 96)

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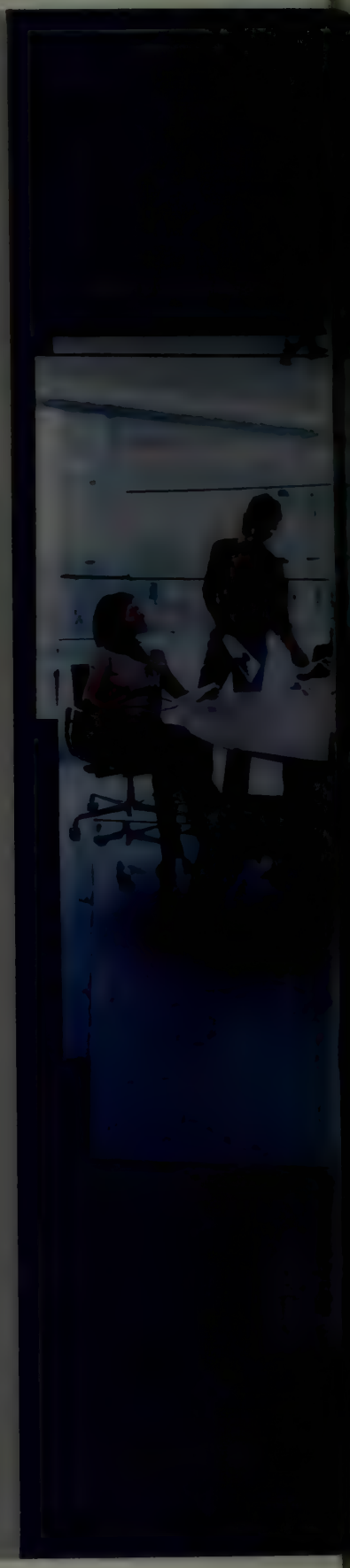

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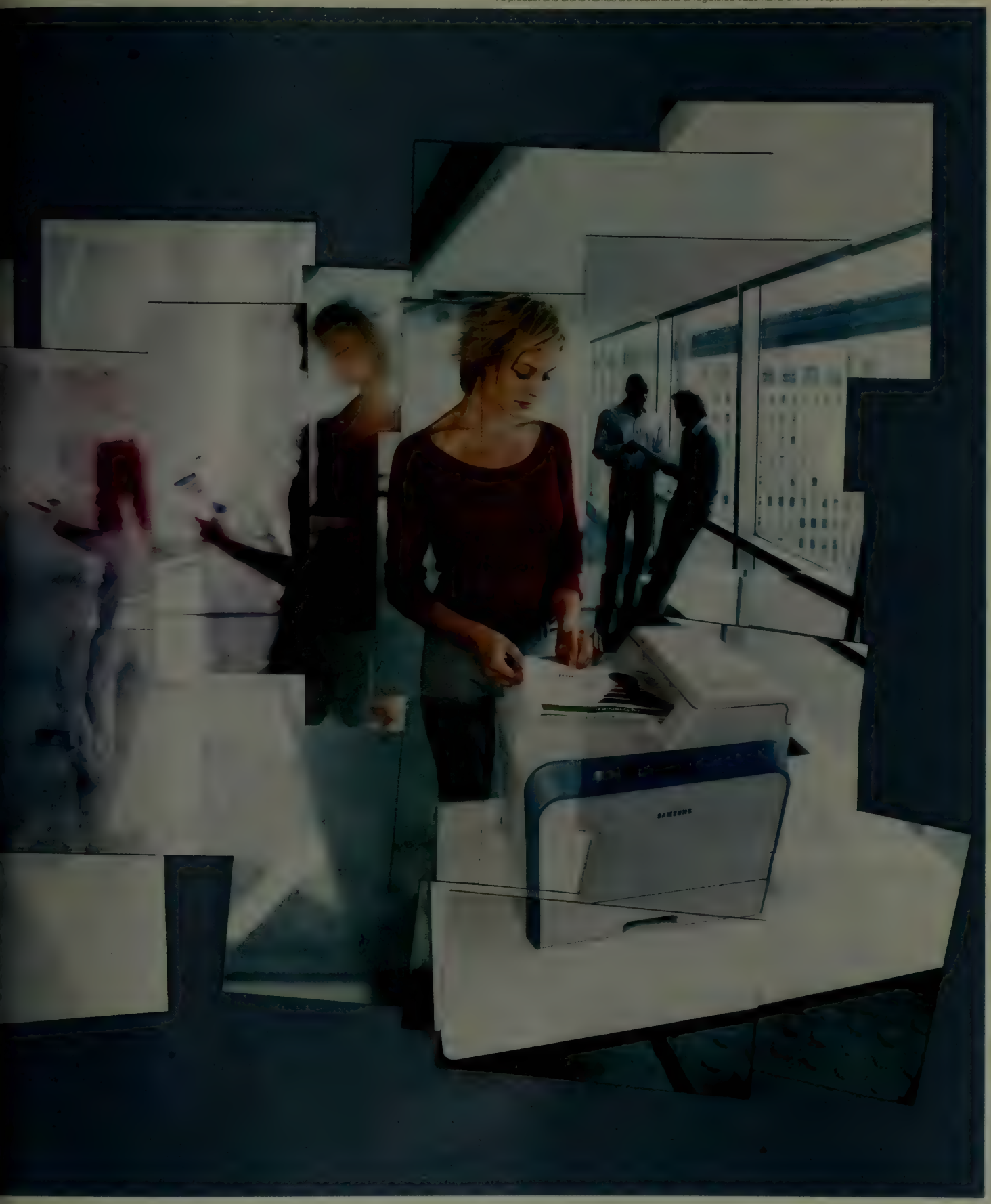

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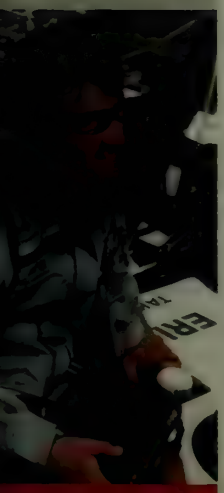
The challenges of the race will mirror the day to day issues of many businesses, such as fierce competition, multiple partners and a rapidly challenging and highly complex environment.



It's been called the toughest challenge in the world of sport. To even have a boat in the Volvo Ocean Race requires an incredible investment in people and technology. Enter the Ericsson Racing Team, built on the ability to smoothly and successfully manage this frighteningly complex process. As you would expect from Ericsson, the premier player in the global telecoms industry, superb communications are an integral part of the team effort. This expertise also ensures that this adventure can be followed by nearly two billion mobile subscribers around the world, who can literally join the race whatever they are doing and at whatever time they choose.

THE RACE

The race has been compared to the Olympic Games, as it takes place every four years and requires such intense preparation. It also has a long history, going back to 1973 when it was known as the Whitbread Round The World Race. Boats need to travel a course of over 31,000 nautical miles through some of the most challenging waters in the world, together with in-port races. The Ericsson Racing Team also had to undertake a 2,000 mile qualifier just to show its readiness for the event.

The competition officially starts on November 5th with an in-port race before the boats start their global marathon on November 12th from Vigo in Spain. The race is scheduled to be completed on June 17th, 2006. At each of the nine stops, Ericsson will be hosting a pavilion to showcase the incredible innovation going on within the company and its strategic partners, Sony and Sony Ericsson. These will be divided into three areas; At Home, At Work and En Route.

The pavilions will provide the opportunity to demonstrate the way that Ericsson technology will fundamentally change the way that communications are used. The race provides a great example of this. The pavilion screens will use Ericsson's real-time IP TV solution to broadcast the race. That same footage can also be seen as mobile TV on Sony Ericsson handsets. The Ericsson Racing Team is relying on such state of the art technology and the broad expertise of Ericsson to support the team through this arduous journey.

The challenges of the race also mirror the day to day issues of many businesses, such as fierce competition, multiple partners and a rapidly challenging and highly complex environment. The same skills and experience that will be used by the Ericsson Racing Team also enables Ericsson to help many businesses around the world to succeed.

HOW TO JOIN THE RACE

Only the luckiest, and bravest, can make it onto the boat but Ericsson has provided the technology to allow anyone to get involved in the race. Through a mobile device or on the Internet - by text, audio or video - you can experience what the crew is going through 24 hours a day, seven days a week. Everyone likes to communicate in different ways and Ericsson has developed many ways to follow the race from mobile blogging sites to video streaming to radio clips for mobile users. As the exclusive mobile partner for the Volvo Ocean Race, Ericsson will also be providing a managed service to allow mobile operators to offer content and services relating to the event to their own customers.

To join the race simply register at the Ericsson Racing Team website (address below) or just text "Join" to +46737494949.

WRITTEN BY
STEVE WALLAGE

To follow the Ericsson Racing Team go to
www.ericssonracingteam.com
or text "Join" to +46737494949

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BusinessWeek

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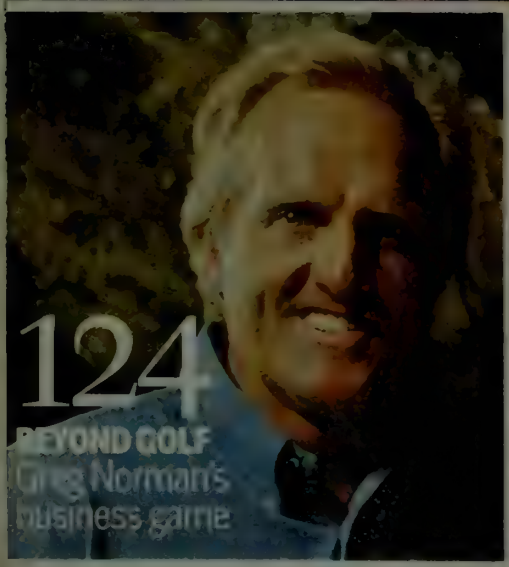
IKEA, THE LIFESTYLE
The retailer is becoming tastemaker to the world's middle class by hewing to design, function, and frugality



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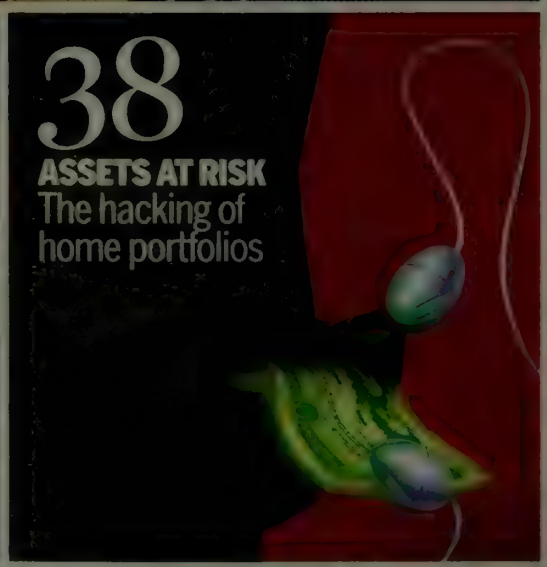
Greg Norman's business game



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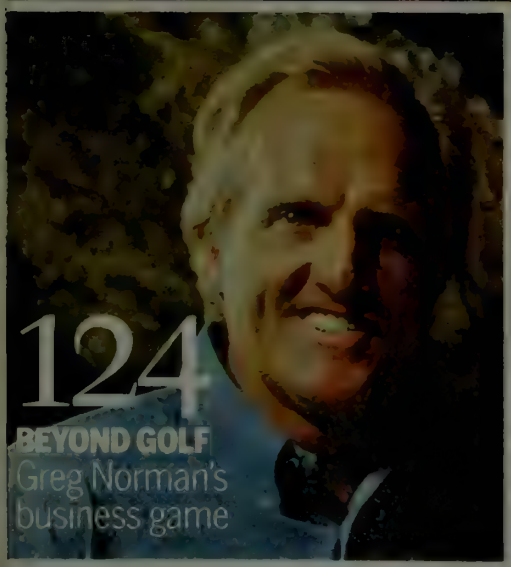

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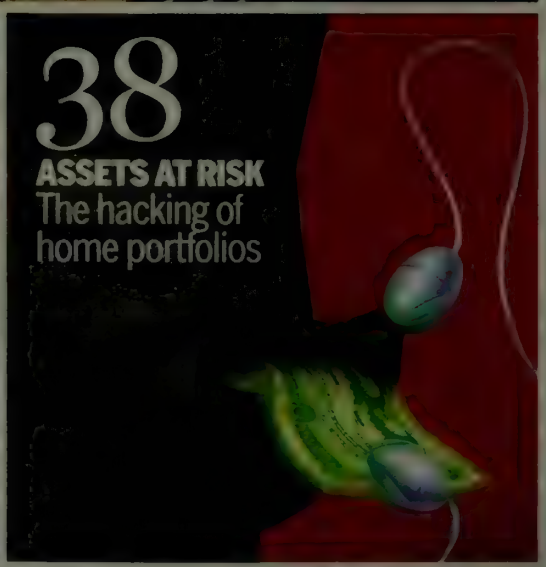

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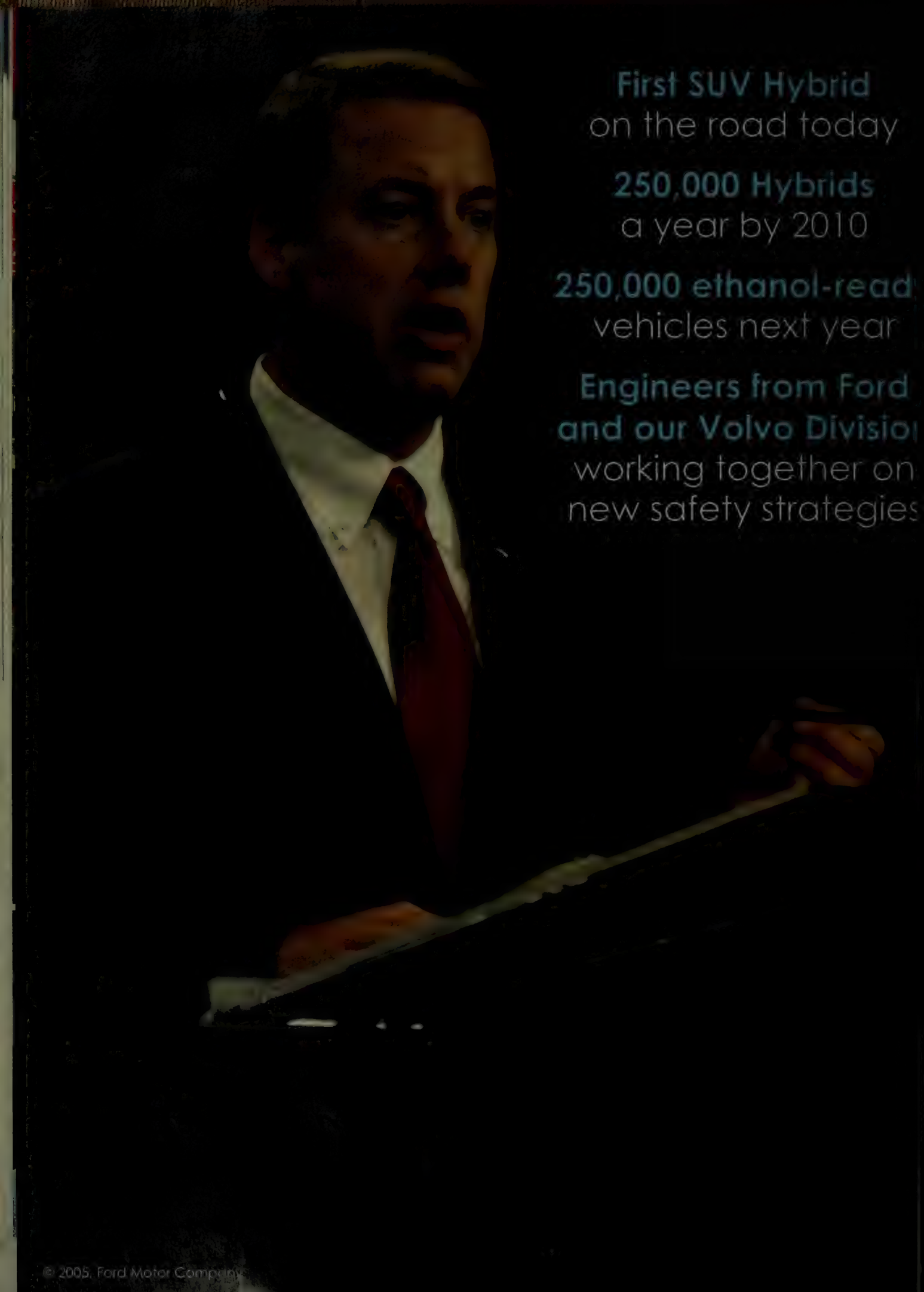

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE*	OUR AWARD
TOP 3 GINS	
Hendrick's $30/750ml	Most Flavorful
Tanqueray No. Ten $26/750ml	Smoothest
Juniper Green Organic $26.50/750ml	Best Presentation

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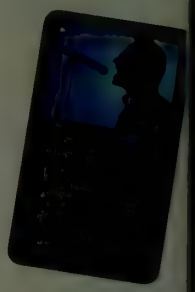
Before you shop, visit BusinessWeek Online's enhanced **Product Reviews** area. You'll find a wide range of Tech reviews organized in easy-to-use categories. Need a new **cell phone** or a **high-definition TV**? Maybe you're looking for a **digital camera** to give as a holiday gift, or need the lowdown on **Web services**, such as photo-sharing sites. You'll find our editors' takes on these and more. Plus, you can leave your own reviews and check out ones from other readers. Stop by soon and become a smarter shopper

More Treat Than Trick On Wall Street

Amid all the uncertainties buzzing about the economy—inflation, political upheaval, a new hand soon guiding the Fed—one fact is beyond dispute: Stocks are relatively cheap

Video iPod: Not Enough Of a Good Thing?



Apple's new digital-media players are hot sellers, judging from the more than 1 million video downloads in the weeks since its release. Just one problem: Is demand outpacing supply?

A Battle Brewing Over Qualcomm's Fees

Europe is again the scene of a bitter high-tech struggle. This one pits a half-dozen rivals against Qualcomm over its cell phone technology licenses

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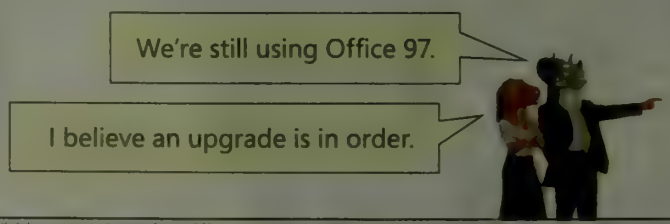

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UP Front

"What comes to your mind when you think of Kenneth Lay?"

–From a questionnaire sent to Houston residents by defense lawyers prepping for his January trial, reported by The Washington Post

DITED BY DAN BEUCKE

PERK PARADE

NICE WORK, IF YOU'RE FROM ECUADOR

URE, OIL EXECS are rolling in ough these days. But in cuador, so are the secre-ries. Thanks to high oil rices and a man-atory profit-haring law, **ccidental Petrol-um's** 350 lucky cuadoran emp-yees are each king home indfall pretax ayments averag-g $130,000 to 150,000.

That's because xy racked up a efty $464 million of local rofits in 2004. With oil prices ven higher this year, office orkers, drivers, and oilfield echanics figure they could et up to $200,000 each. By w, all companies have to distribute 15% of local profits to employees—10% divided equally among workers, the rest distributed by number of dependents. Canada's **EnCana** is the only other oil multinational making such lavish payments this year.

For workers in Ecuador, where annual per capita income is just $2,180, the payments are a bonanza. "It's like winning the lottery, more than once," says one worker. Daniel Almaguer, Oxy's legal counsel in Quito, adds: "I think most of our people realize that just as the price of oil can go up, it can go down, so most of them probably try to invest their windfall in something lasting." He wouldn't know from personal experience, though: As one of 25 expatriate employees, he's not eligible for Oxy's payout.

–Geri Smith

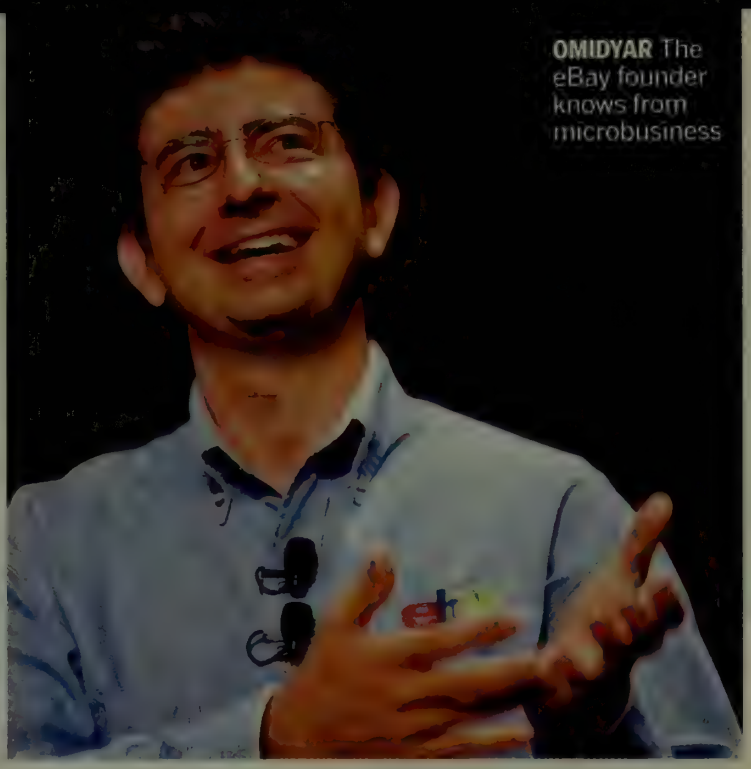
THE BIG PICTURE

OO MUCH MAIL

StopTheJunkMail.com, a service hat helps people remove their ames from mailing lists, has compiled a list of the op catalogs its 2,000 customers ask it to cancel

. THE COMPANY STORE	6. IMPROVEMENTS
. BALLARD DESIGNS	7. FRONTGATE
. POTTERY BARN	8. HOME DECORATORS COLLECTION
. THE SHARPER IMAGE	9. HERRINGTON
. TRAVELSMITH	10. HAMMACHER SCHLEMMER

ata: The Junk Mail Report, StopTheJunkMail.com



OMIDYAR The eBay founder knows from microbusiness

CHARITY CASES

A Big Fund For Tiny Businesses

MICROFINANCE is getting a megaboost. On Nov. 4, **eBay** founder and Chairman Pierre Omidyar and his wife, Pamela, were expected to announce they're donating $100 million to **Tufts University** to create a new fund for microfinance lending initiatives. Typically, microfinance groups lend as little as $40 at a time to people in developing countries—often women creating crafts, selling vegetables, and the like. They repay, with interest, more reliably than consumers in developed countries. Some profitable microlenders exist, such as **Grameen Bank** in Bangladesh, but most depend on donations for the loans.

That's what the Omidyars hope to change. "We'd like to unleash $1 billion in loans through this fund," says Omidyar, who created eBay partly to empower individuals. He owns $8.4 billion of its shares. What's needed, he says, is continued support of traditional institutional investors. Tufts President Lawrence Bacow hopes the **Omidyar-Tufts Microfinance Fund's** annual return will at least match the university endowment's 9% target. Tufts will keep half the income to invest in its own programs; half will be reinvested in more microfinance initiatives.

–Rob Hof

UP Front

AFTER KATRINA

BELLSOUTH'S RIVALS ARE STORMING MAD

RIVAL PHONE COMPANIES are asking whether **BellSouth** is exploiting Hurricane Katrina to win back customers. Alternative local service providers such as **Momentum**

Telecom, Trinsic, and **Access Integrated Networks** resell local phone service purchased from BellSouth—but they are largely dependent on the Baby Bell to maintain and repair their network. Those three carriers, and others, say they're being deluged with calls from small-business and home customers in cities devastated by Katrina.

In some instances, customers of Momentum and the rival carriers complain that BellSouth customers in their apartment complexes, or on their blocks, have had service restored but that they're still phoneless. If they call BellSouth to inquire about the timetable for repairs, the customers claim that BellSouth reps are telling them it will take a month or more to restore service—but they can be up and running, sometimes the same day, if they switch their local phone service back to BellSouth.

A BellSouth spokesman says the company isn't playing favorites: "We are treating all customers the same regardless of the company that provides them service." Still, Access Integrated CEO Vincent Oddo recently met with **Federal Communications Commission** Chairman Kevin Martin to voice his complaints. An FCC staffer says that if a formal complaint were filed, the agency would consider it as a serious matter for investigation. *–Dean Foust*

DISASTER WATCH

ANYONE FEEL LIKE A DRINK?

From the agenda of a Council on Foreign Relations conference on avian flu to be held on Nov. 16 in New York:

3:45 to 5:00 p.m.
Session V: What Will The World Look Like After a Pandemic?

5:00 to 6:00 p.m.
Cocktail Reception

DEVOTED FANS

MY IPOD, MY ICON? The latest offering in the cult of Apple comes from a couple of Christian buddies from Portland, Ore., who launched the iBelieve, a simple plastic fitting that turns any iPod Shuffle music player into a cross worn around the neck. Close to 200 Apple addicts shelled out $12.95 each for the doodad the first day it was offered at Web site www.devoted1.com. Creator Scott Wilson, 36, a product designer for major consumer brands by day and former Catholic schoolkid, says he and business partner Mike Prstojevich asked friends who own an electronics factory in China to produce 350 iBelieves for under $5 each. They're preparing to order the next batch. "We weren't sure if we'd sell 10 or 10,000," says Wilson. *–Esha Bhanda*

DRAWN & QUARTERED

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FACE TIME

BRUCE SHERMAN

A PAPER TIGER WITH CLAWS

Investor Bruce Sherman, 57, looks like the most powerful newspaper wheeler-dealer since William Randolph Hearst. The press-shy CEO of Private Capital Management, a unit of Legg Mason, has accumulated major positions in nearly every U.S. public newspaper company. Now the former accountant is exercising his clout. On Nov. 1 he demanded that the languishing No. 2 chain, Knight Ridder, of which PCM owns a 17% stake, put itself up for sale. Sherman isn't talking, but with his holdings—including 15% of *The New York Times* and 6% of Gannett—he could force a radical restructuring of vulnerable publishers.

Nearly 20 years ago, in one of his first forays, Sherman helped the Collier family sell the *Naples Daily News* for $170 million. The stakes are higher now. A letter from PCM to the Knight Ridder board points to poor prospects for revenue growth in the industry, which is under siege from the Internet, declining and aging readership, and tepid ad spending. *–Tom Lowry*

EXECUTIVE PAY

IT SURE BEATS A GOLD WATCH

AFTER THE SECURITIES & Exchange Commission launched a probe of accounting irregularities at **Dollar General,** Cal Turner Jr. in 2002 returned $6.8 million that he had been paid for results that were eventually restated; he then stepped down as CEO. The gesture was lauded by *BusinessWeek* and others. But in the two years since, Turner has remained employed by—and paid by—Dollar General, based in Goodlettsville, Tenn. After retiring as chairman in June, 2003, Turner stayed on as an adviser to the board: In 2004 he received $275,000 plus $113,000 in perks.

On Oct. 18, Turner fully retired and got another big payout. In an SEC filing reported on the Web site Footnoted.org, Dollar General disclosed that Turner is getting a lump-sum retirement payment of $1 million, access to the company's box suite at Tennessee Titans games, title to a company-owned 2004 Audi A8 that he drives, and up to $100,000 to cover legal and consulting expenses. Dollar General also is making a "gross up" payment to cover taxes on the package. Turner directly owns 3.3% of its shares, worth $200 million.

Nell Minow, editor of the governance Web site **The Corporate Library,** calls the payments "unconscionable in light of earlier accounting troubles. Dollar General says Turner's compensation recognizes 25 years as CEO, plus board meetings and consultation afterward. It was fair, according to a spokeswoman, "given the valuable service that Mr. Turner provided over the course of two years during the transition and orientation of our new executive team." *–Dean Foust*

BLOGSPOTTING

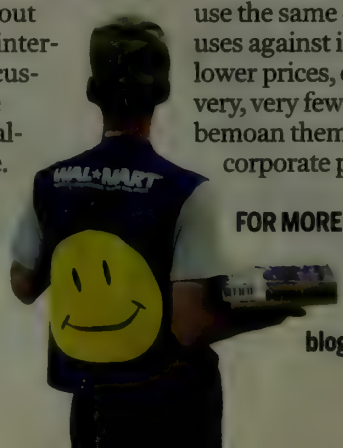
ALWAYSLOWPRICES

alwayslowprices.net

» WHY READ IT: If you're interested in **Wal-Mart,** the largest U.S. private employer, this blog is a rich resource. It bills itself as covering "the best and worst about Wal-Mart," from internal memos to discussions of employee benefits, from a balanced perspective.

» WHO'S BEHIND IT: Eight unpaid bloggers claiming to be independent of Wal-Mart or any opposing group.

» NOTABLE POST: An analysis of a speech by CEO H. Lee Scott points to Wal-Mart's goal of increasing fuel efficiency in its trucks by 25%: "Basically, Wal-Mart is going to leverage its size to obtain environmental goals. It will use the same exact tactics it uses against its suppliers to lower prices, only this time very, very few people will bemoan them as an abuse of corporate power."



FOR MORE on blogs, see Stephen Baker and Heather Green's **blogspotting.net.**

THE STAT

52.4

The percentage of U.S. auto sales held by GM, Ford, and Chrysler in October, their lowest share ever. GM's share fell to 22%, from 25.6% a year ago.

Data: Autodata Inc.

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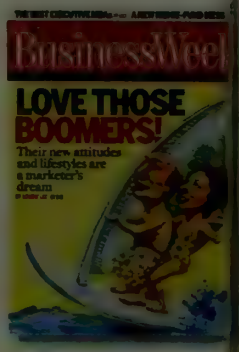
"Yes, it is about me, me, me. It is my, my, my hard-earned money, and it goes to those who respond to my needs."

–Christy Stadelmaier
Boston



BOOMERS: WHAT MARKETERS (AND *BUSINESSWEEK*) ARE MISSING

THANK YOU, Louise Lee, for "Love those boomers" (Cover Story, Oct. 24). It's about time marketers recognized just how valuable we are. I'm not wealthy, but I would spend a lot more if more products were geared to my age group. Walk through any mall, and 99% of the displays are aimed at teenagers and twentysomethings. I don't want to dress like Britney Spears, but I also refuse to dress like a granny. I can't tell you how many times I've just gotten frustrated and gone home—money burning in my pocket. Wake up, America! Don't underestimate us boomers, especially female boomers. After all, guys, we're going to outlive you!

–Margaret Craig
Alpharetta, Ga.

THERE MAY BE many 50-year-olds like myself who have found a way to feel like 25, with plans to live energetically to 150—God willing and given progress in biotech. Therefore, 10% or so of the boomer wave (8 million) may be extremely young investors, with the opportunity to accumulate incredible international wealth in the next 100 years. That's my theory, anyway, and I'm sticking it—25 and holding.

–Thomas Jirgenso
East Wenatchee, Wa

A BOOMER lamentation: I don't pie my parts. I don't want to expose my be I don't show my underwear in public. I sick of black. I want style, not bags. I wa things that work as promised. I wa phone calls returned. I want ord shipped accurately. Yes, it is about n me, me. It is my, my, my hard-earn money, and it goes to those who respo to my needs. They are becoming few and very far between.

–Christy Stadelma
Bost

BUSINESSWEEK has taken a leaders role in fully articulating the business p sibilities ahead. However, your cover lustration is stereotypical and mal boomers appear fatuous and aged yond their years. The matching swi suits are way too un-boomer-like. It's an uplifting illustration but one that inforces negative perceptions of the g eration. When you see this illustrati do you think of Oprah? Steve Jobs? Cl

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ReadersReport

CORRECTIONS & CLARIFICATIONS

In "The forecast: Low visibility on rates" (Business Outlook, Nov. 7), the Bank of Canada's overnight rate as of Oct. 18 is 3%, not 2.75%, as published.

In the table for "Music, lights, action with one click" (The Digital Home, Nov. 7), the Control4 Home Theater Controller should have said the Control4 Wireless Touch Screen, and the price is $1,995, not $1,195.

In "Time for a yearend checkup" (Personal Business, Oct. 31), the level at which children under 14 pay income tax at the parent's rate was in error. The correct amount is above $1,600.

"A rival for BMW?" (Personal Business, Oct. 31), on the Lexus GS 430, incorrectly referred to another new Lexus model as the IS 300/400. It should be the IS 250/350.

ence Thomas? Bill Gates? Meg Whitman?

You've diminished the import of this article with such imagery.

–Brent Green
Denver

"LOVE THOSE boomers!" is a thorough and accurate look at the boomer mindset. Your Do and Don't bullet points help describe our view of self. For instance, "don't" think we want to be 25 again and "do" appreciate that we are comfortable aging but want to look and be healthy. So I am curious why caricatures of what look like seventysomething persons were selected to represent my collective generation. You mentioned Christie Brinkley as an icon of the boomers, and as far as I can tell the art in no way resembles her. Perhaps you could add a final do and don't: Do assume we can spot insincerity when the art doesn't match the article—and don't inaccurately portray what we look like.

–Janet M. Gourley
La Verne, Calif.

FIRST, LET'S stop using "boomers" as a description. The connotation isn't pleasing. Booming waistline? Booming voice? Better to segment by lifestyle. There's no question that a 55-year-old NASCAR enthusiast/six-pack/fishing-boat/rod 'n' reel/RV lifestyler is different from a 55-year-old cruise-travel/white-wine/sailboat/ beachhouse lifestyler, even though there is "crossover."

The key to convincing these disparate segments that a marketer knows what they are about is to depict product usage with models and actors who seem pleasantly realistic and satisfying. And if you don't want cynicism dominating opinion about your products and services, forget about "placements." That's a sure route to "I don't trust____."

–Barry Dennis
Columbia, Md.

AS AN OBSERVER OF the radio business, it hasn't been a pretty view this year. Some of these decisions, such as blowing up an institution [beloved by boomers], WCBS-FM in New York, to try a fad format, would be the equivalent of nuking Macy's and turning it into a really big Abercrombie & Fitch.

–Dave Hoeffel
Lawrenceville, N.J.

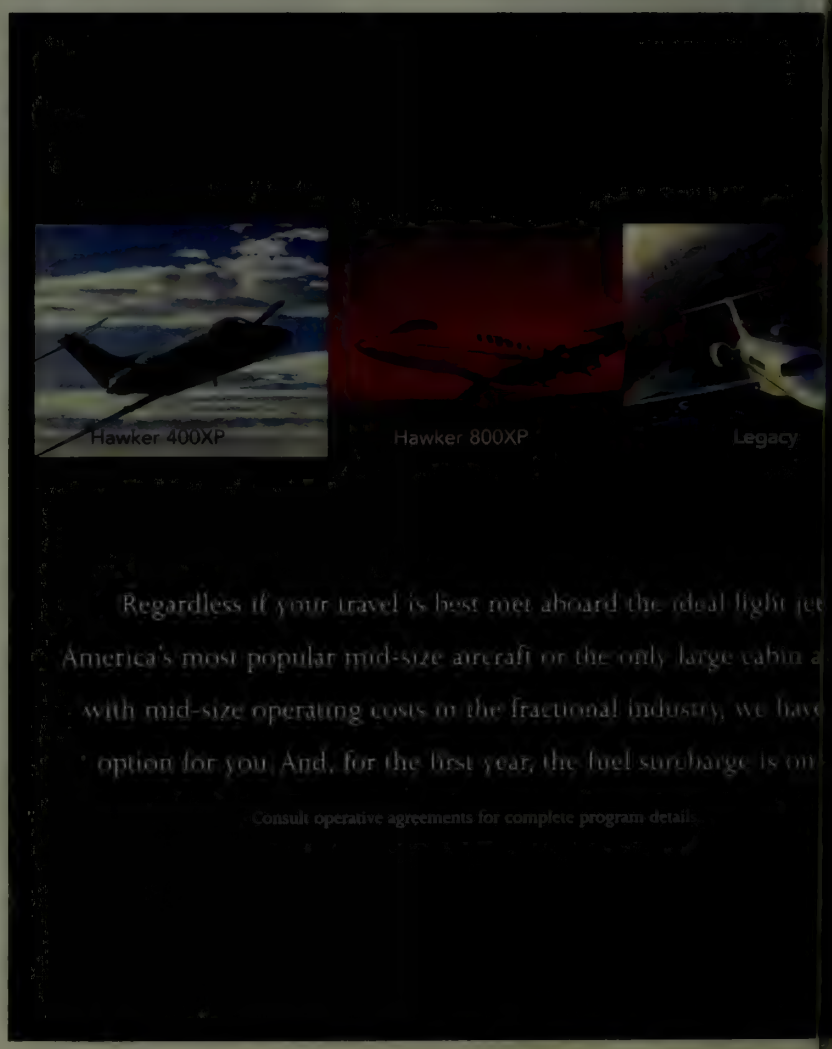
IT'S A TRUISM in sales and marketing that it's far easier and less expensive to keep a customer than to win one. I, like many boomers, recently lost my parents. As executor I found that two major financial-services organizations were so unhelpful, incompetent, and even hostile in their policies and their execution that it was far simpler to liquidate the accounts than transfer ownership. The fact th many companies with gazillion-doll marketing budgets go out of their way antagonize new clients at one of t toughest times in their lives is bafflin These geniuses need to apply for refun on their MBAs.

–Thomas W. Clearm
Canton, (

YOU STATED THAT the average pretax come for members of the baby boom ge eration is more than $57,000. Boom ought to be flush with cash. Yet when Pr ident George W. Bush dared to sugg changes to make the Social Security s tem fairer to those under 50, the boom media acted as if they would be eating food and using light bulbs for warmt such a plan ever came to fruition.

As a member of Generation X, it's b enough that we've had to deal w boomers' moralizing, preening, and s centeredness for 30 years—now we m keep them in a lifestyle to which they become accustomed. The U.S. would better off if the boomers had listened The Who and died before they got old.

–Paul McCr
Ridgewood, N



OON, TV ADVERTISERS ILL BE THANKING STEVE JOBS

'S NOT MOVIES Apple Computer Inc.'s unes Store will revolutionize—it's TV nd the ad industry that fuels it ("Hollyood holds its breath," News: Analysis & ommentary, Oct. 24). Now you can buy st night's *Lost* for $1.99. Next you'll be ble to get it for less in exchange for atching and interacting with targeted ds. The return-on-investment model oogle Inc. has championed, combined ith the customer profiles of an Amaon.com Inc., will let advertisers buy the act eyeballs they want, with a feedback echanism. Bandwidth and digitalghts issues will be solved as the $46 bilon TV ad industry realizes that this is the ture. Hollywood may be the last on this ndwagon, but there's no question that nce again, Steve Jobs is leading it.

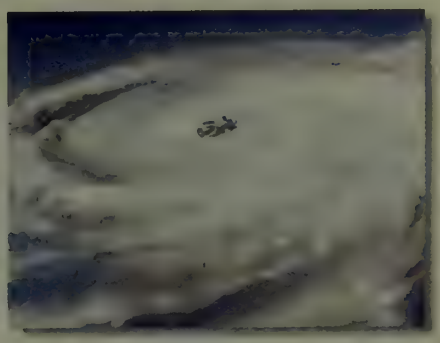
–David Esrati, Chief Creative Officer
The Next Wave
Dayton

OW TO STOP A HURRICANE I ITS TRACKS

OTING THE various schemes you menon to "tame hurricanes" ("Herding urricanes," Science & Technology, Oct. 24), a simpler and more practical way to deprive hurricanes of energy would be to lower the surface water temperature: Dump several thousand tons of a cryogenic liquid (e.g., liquid oxygen at -297F, or even colder liquid nitrogen or liquid hydrogen) in advance of an approaching hurricane. The U.S. Air Force has some 500 KC-135 tankers, each with a payload of some 80,000 pounds. A dozen tankers converted to carry and drop a cryogenic fluid, each flying, say, five missions, could drop 2,000 tons in front of a hurricane, significantly lowering the surface temperature of the water in its path. Depriving an advancing hurricane of its energy would also avoid the legal and political problems that could result from methods designed just to divert its direction.

–William Bailey
Oakton, Va.

> "To 'tame hurricanes' ...lower the surface water temperature."
>
> *–William Bailey*
> *Oakton, Va.*



PERSONALITY TESTS ARE NO SUBSTITUTE FOR INTERVIEWS

I HOPE that everyone read the line "So far there's little evidence that personality profiling works" in "Better loving through chemistry" (Developments to Watch, Oct. 24). As a single person, I have experienced hilarious results with eHarmony. As a business/career coach and human resources consultant, I am horrified at the number of companies that are spending thousands of dollars and leaving themselves open to multimillion dollar discrimination lawsuits by using "personality tests" whose validity equals the tests used by these dating Web sites.

If you can't be bothered to take the time to do a thorough job of vetting your candidates in person using known people-reading techniques, you don't deserve the title of manager.

–Victoria Leo
Cary, N.C.

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Gaming's Grand Master

IN THE EARLY 1980s, Shigeru Miyamoto got his first glimpse of a Rubik's Cube at a toy fair in Japan. The young video-game creator from Nintendo Co. found the six-sided puzzle to be an ideal toy—a cinch to get started, murder to solve, and impossible to put down. Miyamoto kept those qualities in mind when he created *Super Mario Bros.*, which went on to become the hottest-selling video game of all time, with more than 40 million copies sold. And the mustachioed carpenter-turned-plumber was in good company. Six of Miyamoto's games are among the global top 10 sellers.

This winning streak has earned worldwide adulation for Miyamoto, now a senior managing director. When the diminutive 52-year-old dropped by the Nintendo World Store in New York on Sept. 25, he found 1,500 people waiting in line for his autograph and a photo. The line had begun forming two days earlier, with fans flying in from as far away as Europe. "One fan told me: 'You're a god!' I was very embarrassed," he says.

MIYAMOTO
Loyal to a world of young fans

He puts emotions above lurid action

An industrial designer and artist by training, Miyamoto joined Nintendo in 1977 just as the Kyoto-based toy and playing-card maker was venturing into arcade games. His big break came four years later. An arcade game called *Radarscope* had just flopped, crimping Nintendo's ability to sell its arcade machines. Although Miyamoto knew little about electronics, he was asked to create another game that would run on the same hardware. Within months he and a team of engineers had come up with *Donkey Kong*, featuring a cartoon carpenter who strives to rescue his girlfriend from a giant ape. "For those three months, it was all I thought about, 24 hours a day," he recalls. Nintendo quickly shipped 63,400 units, outselling every other arcade machine and making Miyamoto a celebrity.

In 1985, Nintendo began targeting the living room with a console called the Nintendo Entertainment System (NES), and kids quickly got hooked on Miyamoto's *Donkey Kong* a *Super Mario Bros.* The next year he created a labyrinthine fantasy world called *The Legend of Zelda*, which could take skilled gamers days or weeks to complete. In the 1990s, Miyamoto led the charge into 3D graphics with *Super Mari 64*. His latest triumph is *Nintendogs*, a game for Nintendo's top-selling handheld console. It has sold 1.6 million units since its April debut.

Counting all the sequels, Miyamoto's three biggest hits—*Donkey Kong*, *Super Mario Bros.*, and *The Legend of Zelda*—have sold 271 million copies worldwide. Still, Nintendo failed to thwart latecomers Sony and Microsoft, both of which have steamed past Nintendo in the $25 billion-a-ye video-game market. Inevitably, some fault Miyamoto for trying to stay loyal to his relatively young fan base while rivals opted for more realism—read, lurid action—to rope in older players. Many of Miyamoto's games, su as the quirky outer-space adventure *Pikmin*, still resemble cartoons. "We want our games to be for anyone from 5 to 95 years old," he says. "Software makers want games to be so realistic, but first and foremost they should evoke emotions."

In the future the interactive experience may n longer be limited to the four corners of your TV or PC screen. Games may come t fill an entire room, like the holodeck in *Star Trek*, the designer says. But for now, Miyamoto's strategy for expanding Nintendo's $5 billion sales base is to shoot for the broadest possible age ran When Nintendo launches its next-generation platform, dubbed the Revolution, sometime 2006, it will come with controllers that Miyamoto patterned after a simplified TV remote—as opposed to ever-more-complicated game controllers. He can easily envision such gadgets on a coffee table in front of the TV, equally accessib to both young and old. "Most people think video games are all about a child staring at a TV with a joystick in his hands. I don't," he says. "They shoul belong to the entire family." ■■

–By Kenji H

BusinessWeek online For a Q&A with Nintendo's Shigeru Miyamot go to www.businessweek.com/extras

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BY STEPHEN H. WILDSTROM

Wi-Fi Where It Isn't Needed

I have always been a fan of Wi-Fi wireless networking, but lately I'm beginning to wonder if we might not have too much of a good thing. Whil Wi-Fi is wonderful on laptops, the technology is starting to turn up in smaller, simpler devices where it often seems like more trouble than it's worth. Eastman Kodak's new $600 EasyShare-One camera is an example

One of the first Wi-Fi-equipped cameras aimed at consumers, not professionals, the Kodak is an impressive 4-megapixel unit with an excellent lens, an oversize and very bright LCD display panel that doubles as the viewfinder, and 256 megabytes of internal storage. At the push of a button it can dispatch one or more pictures via Wi-Fi for online display at Kodak's EasyShare Gallery (formerly Ofoto). At the same time the camera can send friends or family an e-mail message with thumbnails of the pictures and a link to the Web images.

The EasyShare-One is a much better camera than those you find on cell phones. Trouble is, any camera-equipped cell phone makes it a lot easier to transmit pictures. While the exact procedure varies from phone to phone, it's almost always simple: select a picture, choose a phone number or e-mail address—usually from the phone's address book—and push a button to send.

WI-FI IS MUCH MORE COMPLICATED. First the camera must search for a network, then you choose one if more than one is available. If the network is password-protected, you enter a password using a tiny stylus to tap out letters on a minuscule on-screen keyboard. To send a photo, you then have to use that same stylus and keyboard to tap out an e-mail address since, at least to start with, your camera won't have an address book. You have to use the stylus again to tap out any message.

Once set up for your home network, this works reasonably well—but there are some problems. The original security mechanism for Wi-Fi was badly flawed and has been superseded by a more advanced technique called Wi-Fi Protected Access (WPA). PCs and Pocket PC and Palm handhelds can handle WPA, but the extra complexity causes difficulties for devices such as cameras and wireless music players. Since everything on a Wi-Fi network must use the same security method, putting any of these products on your network forces you to drop back to a weaker form of Wi-Fi security. On my home network, for example, I had to choose between security and using a Roku SoundBridge wireless music player. Kodak acknowledges the problem and hopes to release a WPA upgrade soon.

Sending pics with a Wi-Fi camera can be harder than using your PC

Is the concept worth the trouble? At home it's simple to just dock the camera to a computer and use the keyboard and big display to mail or otherwise share pictures. So wh bother with Wi-Fi? The puzzle grows more vexing if you leave home. Unlike a phone, the camera has to be set up for each network you want to use, and i unusable at most Wi-Fi hot sp Even if they don't require a cre card for billing, hot spots usua make you register with a Web browser, which the EasyShare lacks. Special software lets the camera use T-Mobile hot spots Starbucks and elsewhere, but you'll still be out of luck on oth carriers' networks, including most hotel Wi-Fi.

I don't mean to pick on Koda At least it sent prints wirelessly a $280 EasyShare printer using direct Wi-Fi link. By contrast, I found the Wi-Fi setup on a Hewlett-Packard Deskjet 460 so difficult that I simply gave u

I think Wi-Fi's ubiquity and low cost is tempting manufacturers to embed it where it doesn't belong. The EasyShare camera would do better with phone-type communications, though that's more expensive and complicated. Bluetooth short-range wireless is easy, but it's useful only for printing. What about transferring pictures the old-fashioned way, by docking the camera? Frankly, it's not t much trouble, so for now that's what I'll do. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

When Covers Were Covers

There's one problem with spending a morning with George Lois, the still-snarling lion in winter of advertising and magazine design: I can't print much of it. Lois swears like a sailor with shelves full of dictionaries and anatomy textbooks. ¶ We are here to talk about the sorry state of magazine covers, long ago colonized more or less completely by celebrities and countless come-hither cover lines. Lois just gave a lacerating speech on this topic to a crowd of magazine executives. (It was received with a frisson of masochistic glee.) Right now he's staring at half a newsstand's worth of current magazines. "What could be duller than that cover?" he muses. "Boring. Dull. Mindless. Unambitious. There's no attempt to do anything exciting." A glance at another: "Boy, they retouched the [expletive] out of that [expletive] picture!"

In the 1950s, Lois, now 74, was a boy wonder of the ad world at watershed agencies like Doyle Dane Bernbach. During the 1960s and early '70s, while running his own ad agency, he created iconic *Esquire* covers still beloved by magazine geeks: heavyweight champ Sonny Liston as Santa Claus; Andy Warhol drowning in a can of Campbell's soup; Muhammad Ali as St. Sebastian. "Big idea" covers, as he puts it—a singular image, minimal type, a visual pun. You don't see these anymore. (One exception: new launch *Radar*, for which Lois consults.)

Image genius George Lois now seems quaint—kind of like magazines

LOIS IS EXACTLY the kind of grumpy old man I aspire to be: accomplished, unapologetic, full of great stories. So it is with regret that I point out that the core of his critique—that the infuriating sameness of magazine covers is one reason why so many "sit unsold at the newsstands," as he said in his speech—is dead wrong. And it misapprehends myriad commercial and cultural pressures today that were absent in his heyday.

Every medium has a golden age, where creative mojo and commerce happily overlap: TV news in the '50s, *Esquire* and other "new journalism" havens in the '60s, American cinema in the '70s. These were eras of unconsolidated ownership, when the terrain was new enough th commercial rewards still flowed to th offbeat. Then a few blockbusters—*T Exorcist*, say, or *Star Wars*—changed the calculus for potential profits. The the big players bought up the little guys, as Hearst Magazines did with *Esquire* and MGM's owner did with United Artists.

Welcome to the world today, a wor of big media companies where the bottom line looms larger and larger. And welcome to the current cultural moment. Celebrity has eaten almost everything, and new media choices zoom toward you every day. The fusty magazine format seems quaint. Lois insists, not unreasonably, that no one even attempts ambitious covers anymore. Others cite reasons why. Th big idea cover "is not something a mature, successful magazine can do every month," says David Granger, *Esquire*'s editor-in-chief since 1997. "You won't sell a magazines." (During Granger's tenure, a gradual shi to more standard cover approaches led to increased single-copy sales.) It's a drag when commercial pressures squash aesthetics. But it was ever thus. The spine-tingling statements happen mostly at the margins, save for a few atypical periods.

Lois helped create such a period, though, and he recalls it so vividly that it induces nostalgia for a time you never saw. The printable parts of his syntax are a "rat finks" and "mugs" and "dames." His memories are peopled with Kennedys and heavyweight champs and Andy Warhol. After work you entered the bar, with its scents cigarettes and scotch, while huge postwar sedans glided silently past the window. This time is long gone. Today the street hums with wireless signals, and everyone communes with Treos and Sidekicks. But while Lois is talking, you can only nod and think it must have been great to have been ther

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TheBarkerPortfolio

BY ROBERT BARKER

Novelis: All Set to Gain Speed

Jaguar's new XK sports car, due to hit showrooms early next year, goes 155 miles per hour and looks neat enough. What distinguishes it, though, is its aluminum body, so stiff it also serves as the chassis. As much as auto buffs may admire this lightweight, monocoque design, the new XK is an absolute dream machine for a new company called Novelis.

If that name rings no bells, don't worry. Novelis might be mistaken for Novartis, Novell, or Novellus Systems, even though it boasts greater annual sales than more familiar names including Avon Products or Phelps Dodge (table). Yet Novelis is worth getting to know, and not just because of its choice role as supplier of aluminum sheet for the new XK, not to mention Jaguar's XJ sedan. Based in Atlanta, Novelis was spun off in January by Alcan, the giant Canadian integrated aluminum producer. By August, the stock had worked its way upward, to nearly 29, before a weak second-quarter earnings report sent it plunging. At recent prices under 20, however, Novelis looks to have far more upside than down.

What's a Novelis?

BUSINESS
Global producer of rolled aluminum for cars, cans, construction materials. Spun off by Alcan in January, 2005.

REVENUES
$8.3 billion

OPERATING PROFIT
$272 million

MARKET CAPITALIZATION
$1.5 billion

NET DEBT
$2.7 billion

SYMBOL
NVL

Figures are for the 12 months ended June 30

Data: CapitalIQ

I VENTURE THAT VIEW because, for starters, Novelis is a member of one of the worst-performing groups of stocks this year. Alcan, Alcoa, and the other aluminums together are down an average of 21% in 2005. (To find out why, look to the sharply higher costs for energy, a chief aluminum input, and the damping effect on aluminum prices of supplies from China.) Novelis, however, doesn't fit neatly into this group of stocks. Its business is concentrated not in production of aluminum ingots but in rolling the basic metal into huge coils that then can be cut, stamped, and shaped into food and beverage cans, construction materials such as home siding, foil for food packaging, sheets for printing plates, and, yes, for high-end auto parts. The latter include bodies for Jags, along with hoods and a bunch of other panels for

JAGUAR XK Its aluminum body could roll Novelis stock upward

the Mercedes-Ben Class, Audi's new sports-utility vehic and more.

So, while rising energy costs indisputably weig on Novelis, a key t its strategy is to ke a better grip on th pricing of its own products than the commodity metals makers do on thei One such initiative is its goal of reducing the proportion of total sales, now 20%, whose contracts include metal-price ceilings. These bar Novelis from passing on to food and beverage can customers higher costs for the basic metal. "W are very focused on getting" those limits out of new contrac as old ones expire, a Novelis spokeswoman told me.

Just the same, even the way business is operating today, Novelis is doing O.K. With the global economy expanding—beyond North America, Novelis has vast operations in Europe, Asia, and South America—sales last year rose nearl 25%, to $7.8 billion, with operating income jumping 34%, t $327 million. This year, Wall Street's consensus estimate is for a further 10% gain in revenues, with a small decline in operating income. More alluring to me is that Novelis is producing excess cash. Even after capital spending, which i the past 12 months ran $162 million, and $14 million in dividend payments—the stock yields 1.8%—Novelis still hac $237 million in free cash flow.

Novelis's chief financial challenge is the nearly $3 billion debt that Alcan saddled it with before the spin-off. Through this year's first half, Novelis had devoted $168 million of its free cash flow to reducing those obligations. Paying off still more debt remains a top priority. Novelis hopes within three or four years to have lowered the ratio of debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) from 5:1 to 3:1. As the debt goes down, the value c equity in Novelis goes up. At 20 a share, Novelis' market val is less than $1.5 billion, or six times the past four quarters' free cash flow. Chances are, that multiple will grow as investors get to know Novelis. ■

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BY JAMES C. COOPER & KATHLEEN MADIGAN

How Companies Are Keeping The Midas Touch

They've gained pricing power while curbing labor costs

U.S. ECONOMY Contrary to expectations at the beginning of 2005, American businesses are having a surprisingly good year where it counts most—the bottom line. This was supposed to be the year when slower economic growth and rising costs for both energy and labor would begin to erode margins and cut into earnings. But as reports so far in the third-quarter earnings season show, companies are not doing so poorly. Even in a quarter when companies were buffeted by one of the sharpest increases in energy costs in decades, along with output and distribution disruptions from two hurricanes, earnings are coming in strong and above expectations.

Through Oct. 28, with 341 of the Standard & Poor's 500 companies having reported, 68% have announced earnings above what analysts were expecting at the beginning of the quarter, according to Thomson Financial. Given those profit reports, plus the latest expectations for the companies that have not yet reported, third-quarter earnings should end up rising 16.1% from the previous year. That's greater than the 15.1% gain expected at the beginning of the quarter and close to the 16.8% showing this time last year.

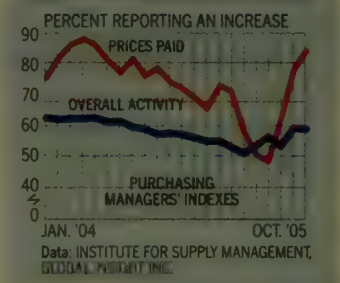
But it's all oil and gas, you say? Not really. With 59% of energy companies having reported, the energy sector is on a pace to rack up a 65% earnings advance from the year before. But even excluding energy, Thomson says the remaining nine sectors should still show double-digit earnings growth of 10.4%.

HOW ARE COMPANIES keeping their golden touch? Strong demand has helped revenues. Real gross domestic product grew at a surprisingly strong 3.8% annual rate in the third quarter, with overall demand rising at an even peppier 4.4% pace. That gap reflects the second straight quarter in which companies liquidated inventories. The combination of shrinking inventories and solid demand bodes well for production gains in coming months, a point bolstered by the upbeat report on October industrial activity from U.S. purchasing managers (chart).

In previous years, companies achieved wider margins and stellar profit growth almost exclusively through stringent cost cutting and productivity gains. As the latest data on employment costs show, companies continue to keep a tight grip on labor costs. That trend is all the more impressive because demand for labor remains solid and productivity growth, which has slowed this year from 2004's strong advance, is no longer supplying the same offsets to rising costs as it had been.

But something else seems to be at work, which is helping companies cope with last quarter's heavy cost pressures and allowing them to maintain high profit margins. That "something else" is stronger pricing power. True, this greater ability to pass along higher energy and other costs has not yet shown up in the price indexes, but economists are starting to think that quirks in the price measures could be disguising inflation's true trend. If anything, the unrelenting strength in earnings argues that better pricing power has taken root, and it will eventually be reflected in the inflation data.

INDUSTRIAL ACTIVITY IS UP, AS ARE PRICES



Data: INSTITUTE FOR SUPPLY MANAGEMENT, GLOBAL INSIGHT INC.

That's why the Federal Reserve's statement after its Nov. 1 policy meeting, at which the central bank lifted its target interest rate by a quarter-point, to 4%, gave no hint that it was ready to end its rate-hiking campaign. Policymakers warned that "the cumulative rise in energy and other costs have the potential to add to inflation pressures," suggesting they will continue to watch the official data to ascertain where inflation is headed.

BUT ARE THE PRICE INDEXES telling the real story? Outside of energy and food, the consumer price index has been exceptionally tame. In the past half year core inflation has run at an annual rate of only 1.3%. But a well-documented quirk in the CPI's gauge of the cost of homeownership may be holding down the core rate. The government estimates the cost of homeownership based on the equivalent rental value of a home. To get a clean measure of rent only, it subtracts utility costs from some rents. When utility costs accelerate sharply, as now, that subtraction greatly reduces rental values and, thus, homeownership costs, which make up a substantial 30% of core CPI inflation.

The same effect appears at play in the costs of lodging away from home, "but on a much more dramatic scale," notes chief economist Ian C. Shepherdson at High

Frequency Economics. The change in lodging costs, which account for another 3.9% of core inflation, went from 8% per year in March to –2% in September. Shepherdson's analysis suggests the shift is fully accounted for by the steep runup in utility costs, a point bolstered by the fact that Smith Travel Research says its measure of national room rates is up 5.3% from the year before, with revenue per room up 9.1%.

Other price measures and anecdotal reports also suggest companies may be lifting prices by more than what's indicated by official indexes. The index of prices paid in the October purchasing managers report from the Institute for Supply Management continued its sharp rise to a level close to historically high readings. Plus, an increasingly large percentage of purchasers say that delivery times are slowing and that inventory levels are low. These conditions suggest constraints on output and distribution that typically give companies an edge in setting prices.

ANY GAIN IN PRICING POWER this year was expected to offset an acceleration in the growth of labor costs, the biggest expense for most companies. But it hasn't quite worked out that way. Businesses are holding the line on compensation gains, helping to limit the increase in unit labor costs even while productivity slows down.

According to the Labor Dept., hourly employment costs for private businesses rose 0.8% in the third quarter from the second and 2.9% from previous-year levels. That was the smallest annual gain in eight years (chart).

What is interesting is that, even as the labor markets tighten and companies report shortages of some skilled workers, hourly wages, salaries, and benefits are growing more slowly than they were when this economic upturn began four years ago. Over the past year, wages and salaries are up 2.2%, the smallest gain since Labor began tracking employment costs in 1980. And benefits have risen 4.8% compared with a 7% advance the year before. Much of that slowdown was centered in health-care costs.

COMPANIES ARE REINING IN LABOR COSTS

As was made clear in General Motors Corp.'s decision to cut health-care costs for retirees, companies are looking down every avenue to find ways to control labor costs. One strategy will be further investment in productivity-enhancing equipment which will make workers more efficient.

In 2006, look for greater business spending to lead overall GDP growth even as the slowdown in wage gains and borrowing temper real consumer spending and as higher interest rates cool off housing. Increased equipment spending may also yield another economic benefit. Its lift to productivity could mean another positive surprise from profits next year. ■

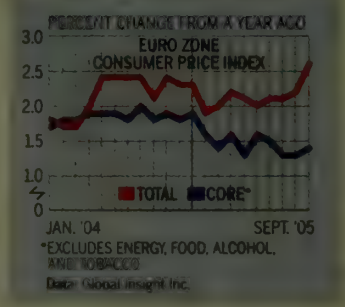
EXCHANGE RATES

Euro Zone Inflation Fears May Sap the Dollar

THE PASS-THROUGH of higher energy costs into nonenergy prices is a global inflation concern. But there's a twist. How aggressively other central banks respond to those worries could have significant implications for the dollar in 2006.

That's especially true for the greenback's value vis-à-vis the euro. The dollar could weaken for two fundamental reasons: One, the European Central Bank may well be raising interest rates just as the U.S. is ending its rate hikes. That would increase the relative attractiveness of euro-denominated securities. And two, growth in the euro zone economy may be picking up at a time when U.S. growth is slowing a notch, another relative plus for euro assets.

HOW MUCH WILL CORE INFLATION ACCELERATE?



ECB officials have been sounding more hawkish lately about inflation's potential threat, causing analysts to believe the central bank may soon begin raising rates for the first time in five years. Upbeat business surveys, especially from the lagging German and Italian economies, suggest growth in the second half is rebounding. The pace of the closely watched money supply has accelerated. And inflation, at 2.6% in September, continues to exceed the ECB's 2% target.

Core inflation, which excludes fuels and other items, stands at a tame 1.4%. But a study by UBS economists in London suggests that the ECB has good reason to worry that higher energy prices will fuel inflation more broadly. They compared the tendency to pass through higher energy costs into the prices of other products in both the U.S. and the euro zone. Their results show that a rise of one percentage point in overall inflation in the U.S. leads to only a 0.1- to 0.2-point rise in core inflation, down sharply since the 1970s. In Germany, however, the same one-point climb overall is likely to yield a 0.8-point rise in core inflation, a result no different from the average experience of the past. The higher sensitivity most likely reflects Germany's less competitive and less flexible labor markets.

A plus for the U.S.: If higher euro zone interest rates lift the euro, a lower dollar and stronger growth abroad will boost U.S. exports and the profits of U.S. multinationals. ■

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CYBERCRIME

INVASION OF THE STOCK HACKERS

An alarmed SEC says that teams of thieves are lifting passwords from home PCs—and emptying online brokerage accounts

BY AMY BORRUS

ARRIVING HOME FROM a five-week trip to Belgium and India on Aug. 14, a jet-lagged Korukonda L. Murty picked up his mail—and got the shock of his life. Two monthly statements from online brokerage E*Trade Financial Corp. showed that securities worth $174,000—the bulk of his and his wife's savings—had vanished. During July 13-26, stocks and mutual funds had been sold, and the proceeds wired out of his account in six transactions of nearly $30,000 apiece. Murty, a 64-year-old nuclear engineering professor at North Carolina State University, could only think it was a mistake. He hadn't sold any stock in months.

Murty dialed E*Trade the moment its call center opened at 7 a.m. A customer service rep urged him to change his password immediately. Too late. E*Trade says the computer in Murty's Cary (N.C.) home lacked antivirus software and had been infected with code that enabled hackers to grab his user name and password. The cybercriminals, pretending to be Murty, directed E*Trade to liquidate his holdings. Then they had the brokerage wire the proceeds to a phony account in his name at Wells Fargo Bank. The New York-based online broker says the wire instructions appeared to be legit because they contained the security code the company e-mailed to Murty to execute the transaction. But the cyberthieves had gained control of Murty's e-mail, too.

"I'M SHOCKED"

E*TRADE RECOVERED some of the money from the Wells Fargo account and returned it to Murty. In October, the Indian-born professor reached what he calls a satisfactory settlement with the firm, which says it did nothing wrong. Still, Murty suffered many sleepless nights. "I'm shocked. We didn't know people could play these kinds of tricks."

Increasingly, they can—and do. In t latest, most pernicious twist yet on Inte net securities fraud, online brokerage a counts are being looted by hackers wh exploit the weaknesses of investors' cor puters rather than the firms' systems. I a new scam, but it's mushrooming. S months ago, Securities & Exchange Cor mission investigators say, such schem weren't even on their radar screen; no the agency is knee-deep in them.

Alarmed, the SEC and FBI are hot on t trail of the cyberperps, with dozens of i vestigations in progress. To head off mo attacks, the SEC is posting a warning on i Web site with tips on safeguarding onli trading accounts (table, page 40). "It's new and growing area that is more int cate and more complicated than other I ternet-related securities frauds," war John Reed Stark, the SEC's chief of Intern enforcement. "And it is still evolving."

So far, the reported losses from onli brokerage accounts are modest: more than $20 million stolen in the pa

SO IN THIS SECTION:

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52 Fidelity: Dear Abby, What happened?

year. But Web investing is a target-rich environment for thieves: Consumers have $1.7 trillion worth of assets with online brokerages, says TowerGroup, a financial research and consulting firm.

MURTY $174,000 was gone from his E*Trade account

As with the Murtys, brokerages often help customers recover their money, or reimburse them for losses. But the hit on the industry could be enormous, especially if hacker attacks drive investors off-line. "The real cost of security lapses is the loss of confidence," says Ravi Ganesan, CEO of TriCipher Inc., a San Mateo (Calif.) developer of authentication systems. That's why brokers are offering customers an array of free or discounted security measures. "If we want our company to continue to be successful, people have got to feel safe and secure when they come here," says E*Trade President R. Jarrett Lilien.

LOOK TO EASTERN EUROPE

HOME PC USERS ARE frighteningly vulnerable. The spread of high-speed and wireless connections has made it easier than ever for hackers to barge in. Even so, an October, 2004, survey by America Online and the National Cyber Security Alliance found 84% of computer users keep sensitive personal information, including financial data, on their home PCs.

To hijack brokerage accounts, hackers have raised their game to a new level. These invasions, law enforcers say, involve hacking or phishing to extract customers' information combined with identity theft, and securities fraud in complex scams executed by gangs. "Generally, it's two or three people working together," says an FBI expert. "The usual profile is people with graduate degrees in finance or banking." The FBI, Secret Service, and private security firms believe most online stock thieves are based in Eastern Europe.

Fortunately, some customers spot hacker intrusions before financial disaster strikes. George Rodriguez, 41, was working from his Waxhaw, (N.C.) home at 9:31 a.m. on May 5 when a series of e-mail messages from Ameritrade Inc. started flashing across his computer screen. Within minutes his holdings in Home Depot, Ford Motor, Duke Power, and Pfizer were all sold. Some $60,000 worth of blue-chip stocks were drained from an account that Rodriguez had traded actively in the dot-com days but largely ignored since 2001.

What saved Rodriguez: The crooks somehow failed to change the e-mail address for trade confirmations. "If they had done that, or if I had been on vacation, I could have been wiped out," says Rodriguez, a partner at real estate investors Waterstone Capital Advisors in Charlotte, N.C. Ameritrade "said they would cancel the orders 'as a courtesy,'" he says, so he didn't lose any money. Says a spokeswoman for the Omaha broker: "The unfortunate events that happened to [Rodriguez] are an issue that Ameritrade and the financial industry have to deal with."

Still, brokers say customers must protect themselves. Crooks "are sniffing the information from the customers' computers, not getting it from our networks," says David S. Kalt, chief execut of online broker OptionsXpress Holdin Federal investigators agree with this. "T integrity of brokerage firm comput seems to be flawless," says an FBI sour

But even if invest are careless, online b kers know that e-trad could dry up if users spooked. That's w Ameritrade offers c tomers a program t scans a PC for malici code when they log on the Internet. E*Trade April began offering tokens, devices that ge erate a new six-digit l in code every 60 secon to investors with $50,0 or more in their accoun More than 10% of da log-ons to E*Trade u the devices. In Janua E*Trade will unveil s newer trading safeguar that President Lili promises "will make o secure ID program lo old-fashioned."

Online brokers cou take a page from ban which next year will be quired to use state-of-th art safeguards. Ma cyberexperts believe th instead of blaming customers, the b kerage and high-tech industries need take the lead educating customers a supplying them with the gear and so ware they need to make their trading s cure. Says Robert K. West, CEO of Ech lon One LLC, cybersecurity consultants Mason, Ohio: "In a society that can't s the clocks on its VCRs, it's nuts to expe people to keep up with all these patch and firewalls." Hackers, of course, a hoping investors stay in the dark. ■

–With Mike McNamee in Washingto Brian Grow in Atlanta, a Adrienne Carter in Chica

VANISHING ASSETS

Computer fraudsters can now clean out your online brokerage accounts without your knowledge. Here's how:

1. **CROOKS USE** a virus or a key-logging program to hack into your PC to get account details and passwords
2. **ONCE IN YOUR** account, they sell some or all of your stocks over a few days
3. **THEY DIRECT** your broker to move the cash, usually to a bank account opened in your name
4. **ASSOCIATES PULL OUT** money as cash and wire it to a hard-to-trace offshore account

Data: Securities & Exchange Commission

A Hacker-Proof Portfolio

SHIELD your PC and wireless router with firewalls and software to catch viruses and spyware; turn on automatic updates.

CREATE tough-to-crack passwords, change them often, and don't let financial programs or Web sites autosave them.

IGNORE e-mails urging you to click on a link to verify account information. These are sent by phishers, not by banks or brokers.

CONNECT to your account only from your own PC; never connect from a public hot spot where eavesdroppers may lurk.

AVOID unknown sites offering free music and game downloads; hackers often plant spyware and viruses there.

CHECK out investor alerts at NASD (nasd.com/investor/alerts/) and the SEC (sec.gov/investor/pubs/onlinebrokerage.htm).

GREEN MACHINES

WHAT MAKES A HYBRID HOT

Buyers seem to prefer ones that feel, um, weird to drive

BY DAVID WELCH

With gas sky-high, hybrids should be red hot. Well, yes and no. While the Toyota Prius sells in eight days, the Honda Accord hybrid takes some two months—just shy of the industry average—to exit the lot, says J.D. Power & Associates Inc. The Civic hybrid is no Prius, either; it takes 36 days to move.

Clearly, the Prius's conspicuous display of uber-greenness is key to its success. But it and the briskly selling Toyota Highlander, Lexus RX 400h, and Ford Escape hybrid SUVs also feature a radically new driving experience. It's quite a thrill to hit the accelerator and slip along in near silence. Not so for Honda hybrids. Because the gasoline engine is working most of the time—getting an electrical boost during acceleration—it drives much like a regular car. Honda says its technology is fuel efficient and cheaper, but that may not be enough to wow drivers.

It doesn't help any of the hybrid makers that fuel consumption fails to match what's advertised. The Environmental Protection Agency ratings touted by car companies are based on lab tests, which don't reflect real-world conditions. For Honda, it's a double-whammy: fuel consumption that doesn't meet the EPA rating, and hybrids that don't drive in a way that surprises consumers.

Toyota Prius

Lexus RX 400h

Toyota Highlander

	TOYOTA PRIUS	LEXUS RX 400h	TOYOTA HIGHLANDER	FORD ESCAPE	HONDA CIVIC	HONDA ACCORD
Days to Sell	8	10	16	34	36	56
Est. Annual Sales	105,000	22,000	20,000	24,000	28,000	20,000
Base Price	$21,275	$48,535	$33,030	$27,515	$21,850	$30,140
Premium Over Regular Model	$1,150*	$11,110	$6,590	$3,300	$2,790	$3,290
EPA MPG (city/highway)	60/51	31/27	33/28	36/31	49/51	29/37
Consumer Reports MPG (city/highway)	35/50	16/29	16/28	22/29	36/45	18/37

Ford Escape

Honda Civic

Honda Accord

*Compared to four-cylinder Camry
Data: JD Power & Associates, Inc.; Companies; Environmental Protection Agency; Consumer Reports

ENTREPRENEURS

EVER WONDER WHY INK COSTS SO MUCH?

So did upstarts that are refilling printer cartridges—and nipping at the big boys

BY PETER BURROWS

PRINTER MAKERS HAVE long known that ink is as good as gold. Just ask the folks at market leader Hewlett-Packard Co. Analysts say ink and toner supplies made up more than 50% of fiscal 2004 profits for the computer giant, although they brought in less than a quarter of the company's $80 billion in sales.

But now a new breed of fast-growing upstarts is out to crash the profit party. Across America, retail stores are cropping up in strip malls among the Gaps and Wal-Marts where consumers and small-business owners can go to have empty printer and toner cartridges refilled—usually for half of what it costs to buy a new one. The largest of these outfits, Cartridge World, based in Australia, just passed 1,000 stores worldwide, and its North America affiliate has opened 275 stores in the U.S. since mid-2003. The company is signing up a new U.S. franchisee daily and plans to top 3,000 stores in the country by early next decade.

What's driving this latest franchising craze? Prices that draw nearly as much ire from consumers as does a trip to the gas station. Burt Yarkin, chief executive of Emeryville (Calif.)-based Cartridge World North America, likes to point out that the ink inside a new cartridge from HP, Lexmark, or Canon costs more per ounce than Chanel No. 5 or Dom Perignon champagne. "People know they're getting ripped off," says Yarkin. "We're giving consumers and businesses a choice."

Most Cartridge World outlets offer refills and clones that are cheaper than brand-name cartridges. The cost of refilling typically runs 40% to 60% of the cost of a brand-name product. An HP 45 inkjet cartridge sold through HP's Web site will set you back $30, while the Cartridge World in Conroe, Tex., will refill an empty one for just $16.50. "Our service has been unbelievably well received," says store owner Jim Spillman, a former Electro Data Systems executive. "Everyone li to save money."

There have been ways to reduce pri ing costs for years for shoppers willi to deal with messy do-it-yourself re kits or buy from online outfits with if quality products. But the new ret chains will make reuse an option for m lions of mainstream PC owners. Cu tomers can either wait for a few minu for their cartridge to be refilled, or pi up a "pre-filled" one in stock. Rapid R fill Ink International Corp., based Springfield, Ore., even sets up drop bo es at coffee shops and dry cleaners. Mo refill franchisees also have their ow vans to do pickups and delive ies to local businesses, usua at no extra charge.

NICE MARGINS A California Cartridge World franchisee fills recycled ink cartridges

QUIET LEGAL PRESSURE

HOW CAN THESE operatio undercut the printer giants so much? Mostly, it's becau those giants have been caref to maintain their ink pro margins at sky-high leve even if it means selling sor printers at a loss. And wh they spend lavishly on resear and development—HP, for e ample, has 4,000 patents a 2,000 full-time engineers in printer supplies business—t chains' costs are much mo pedestrian. They buy in made by third-party supplie often for less than $1 per ca tridge. After paying rent and salaries for few staffers and buying some low-tec equipment, they can easily clear 20% n margins, say industry sources.

This results in a tricky balancing a for HP and its ilk. If they cut prices, the sacrifice margins. Yet if they make a b show of trying to shut down this fas growing industry—say, by creating tec nologies that make it impossible for r fillers to reuse cartridges—they ris raising the ire of consumer advocat and regulators, not to mention drawin attention to a low-cost alternative their products. So far, HP has chosen maintain quiet legal pressure to mal sure the chains play fair. On Oct. 20, sent a letter threatening litigatio against Cartridge World, alleging th some of its inks infringed on patente

More Precious Than...

Ink is darn expensive—which is why consumers are looking to no-name alternatives

	PRICE PER OUNCE
Brand-name printer ink	$34
Chanel No. 5 eau de Parfum	29
Dom Perignon, 1990 vintage	13
Rosebank single malt, 22-year-old	7

Data: BusinessWeek, Lycra Research Inc.

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HP ink formulations. Says HP printer supplies chief Pradeep Jotwani: "We support fair and free competition. All I want is to make sure there's a level playing field."

The question is whether HP will be able to maintain that stance or be forced to scrap with this new class of rivals. Analysts at Lyra Research Inc. figure that refillers already have grabbed roughly 5% of the $59 billion global market. Together with knockoff brands, this aftermarket could rise from 23% in 2004 to 31% in 2009.

VAST POTENTIAL

TO BE SURE, most consumers will still pay up for brand-name ink and toner cartridges. While the quality of refilled cartridges has improved, some independent analysts say a tangible difference still exists. "I use aftermarket ink all the time," says Lyra Research analyst Jim Forrest. "But when I print a photo of my grandson, I'll use the genuine ink. HP guarantees it for 100 years on their paper, and the quality is a bit better. You can see it."

Most users still prefer brand-name ink

And the printer makers are by no means sitting still. They're continually coming up with better printers, most of which have their own ink or toner cartridges. That forces aftermarket rivals to race to keep up with the latest innovations. "This business is driven by technology," says Jotwani.

Still, even a few points of market share mean years of vast growth potential for refillers. Cartridge World, which got its start in 1997, now has franchises in 30 countries and generated roughly $300 million in sales last year. And it has honed a model that's attracting a wide range of franchisees, who can earn $80,000 per year per store, even after paying the 8% franchising fee. Many are now scrambling to open their second or third stores.

That includes 29-year-old Matt Rissell, a former salesman for Verizon Communications Inc. whose first store is Cartridge World's top-selling outlet. The location: Boise, Idaho, home of HP's laser printer division. "We get quite a few HP employees in here," says Rissell. "They're usually skeptical when they first come in, but then come back and say, 'I can't believe it. The cartridges worked perfectly.'" ■

CHOOSE US Gates may have a hard time coaxing consumers

THE INTERNET

OPENING NEW WINDOWS ON THE WEB

Microsoft unveils Net services to push back against Google, Yahoo, and other rivals

BY JAY GREENE

MICROSOFT COULDN'T BE accused of overhyping its announcement of a major new Internet initiative in San Francisco on Nov. 1. In fact, the company even tried to play it down. Yet when Chairman William H. Gates III took the podium in a hotel ballroom, it soon became clear this could be Microsoft's most important Net strategy announcement since it launched the famous browser war against Internet pioneer Netscape Communications Corp. a decade earlier.

At the event, Gates proclaimed the era of "Live software" and insisted Microsoft Corp. would play a major role in a new generation of computing. He laid out plans to create a series of so-called Web services. Unlike traditional software such as Microsoft Word, which resides on a PC, Web services run on Web sites and can be reached through any browser. The company is developing two families of these services—one called Windows Live for consumers, another called Office Live for small businesses. They're online counterparts to its Windows and Office franchises, and will largely be paid for by advertising. M crosoft plans to make it easy for cu tomers or independent software deve opers to build their own Web services interact with its technology. "The Li era is just starting," Gates says. "It's new way to look at software and a bett way to create opportunities."

PLAYING CATCH-UP

WHILE GATES SOUNDED like a pionee Microsoft is playing catch-up in the nev generation Internet technologies, con monly called Web 2.0. The trailblaze are Internet search giant Google, We portal Yahoo!, business services provid Salesforce.com Inc., and a host of tir startups. Web surfers can write doc ments at Writely.com and create sprea sheets at Numsum.com—things the used to have to buy traditional softwa to do. These outfits offer easy-to-u services that are inexpensive or free, o ten supported by advertising. "I woul hope this changes the business model [Microsoft] radically, because that's th way the business is going," says analy Rick Sherlund of Goldman, Sachs & Co

While it's now clear that Microso gets it, it's not at all clear if the compar

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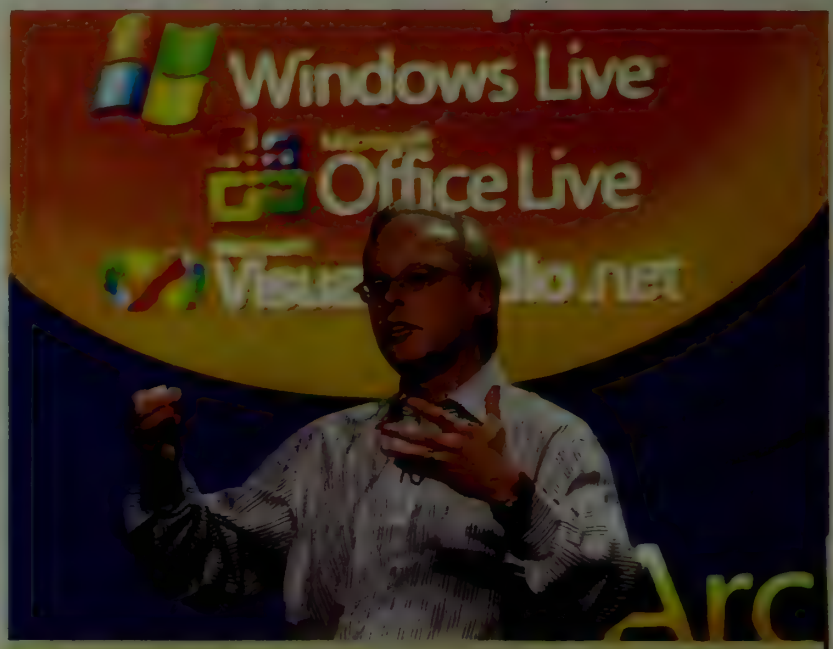
can actually do it. The software giant's MSN unit has been an also-ran to Google and Yahoo in online ad sales, the exact type of revenue the company needs to generate in order to make this business a success. JPMorgan Equity Securities Inc. says MSN posted advertising revenue growth of 20% last quarter, compared with the 40% and 108% at Yahoo and Google, respectively. "Just getting it ain't going to be enough," says Credit Suisse First Boston analyst Jason Maynard. "They are significant share losers to Google."

The software giant's competitors made light of its pronouncements. "They are under substantial attack by companies like Google, Yahoo, and Salesforce.com, and they have to recreate themselves: They have no choice," says Marc Benioff, chief executive of Salesforce.com. Benioff maintains that even with its new Web strategy, Microsoft is not yet capable of creating and introducing new services as rapidly as its nimbler adversaries.

Still, Microsoft's San Francisco event was eerily similar to its famous Internet strategy day of Dec. 7, 1995. Back then, Netscape and its popular Internet browser made Microsoft's Windows seem less relevant. Starting that day, Microsoft used its Windows monopoly, an army of developers, and its influence with PC makers to bury Netscape. That strategy, in part, also resulted in a federal antitrust case that Microsoft settled in 2000. Gates made a passing reference to the 1995 occasion, calling it "a big event, equivalent to this one."

This time, Microsoft will have a harder time using the Windows franchise to gain advantage. "I don't see them leveraging their monopolies," says analyst Charlene Li of tech market researcher Forrester Research Inc. "This is about them having to convince users that their services are something they want. It's an acknowledgment that the users get to choose."

Will consumers choose Microsoft? With Windows Live, Microsoft has created a Web site, Live.com, where people can create personalized Web pages. In addition to headlines from their favorite sports teams and local weather, they can check out feeds from blogs and audio podcasts. And it will let users post content from their PCs, like documents they've recently read, to their personal Web pages, giving Live.com features that popular services such as My Yahoo lack.



LEADING THE CHARGE Ozzie, Microsoft's new chief technology officer

Microsoft Goes "Live"

On Nov. 1, Microsoft unveiled two sweeping new Web service initiatives:

WINDOWS LIVE

» A Web site, Live.com, where consumers can personalize their digital activities and keep them all in one place—including e-mail, blogging, photo sharing, collecting podcasts, and instant messaging. Microsoft will make money from advertising and subscription fees.

OFFICE LIVE

» Targeted at small businesses, it enables them to set up Web sites and e-mail systems, provides online collaboration tools for teams, and has software for handling customer relations. It, too, will be supported by advertising and subscriptions for more advanced services.

WORKING ONLINE AND OFF

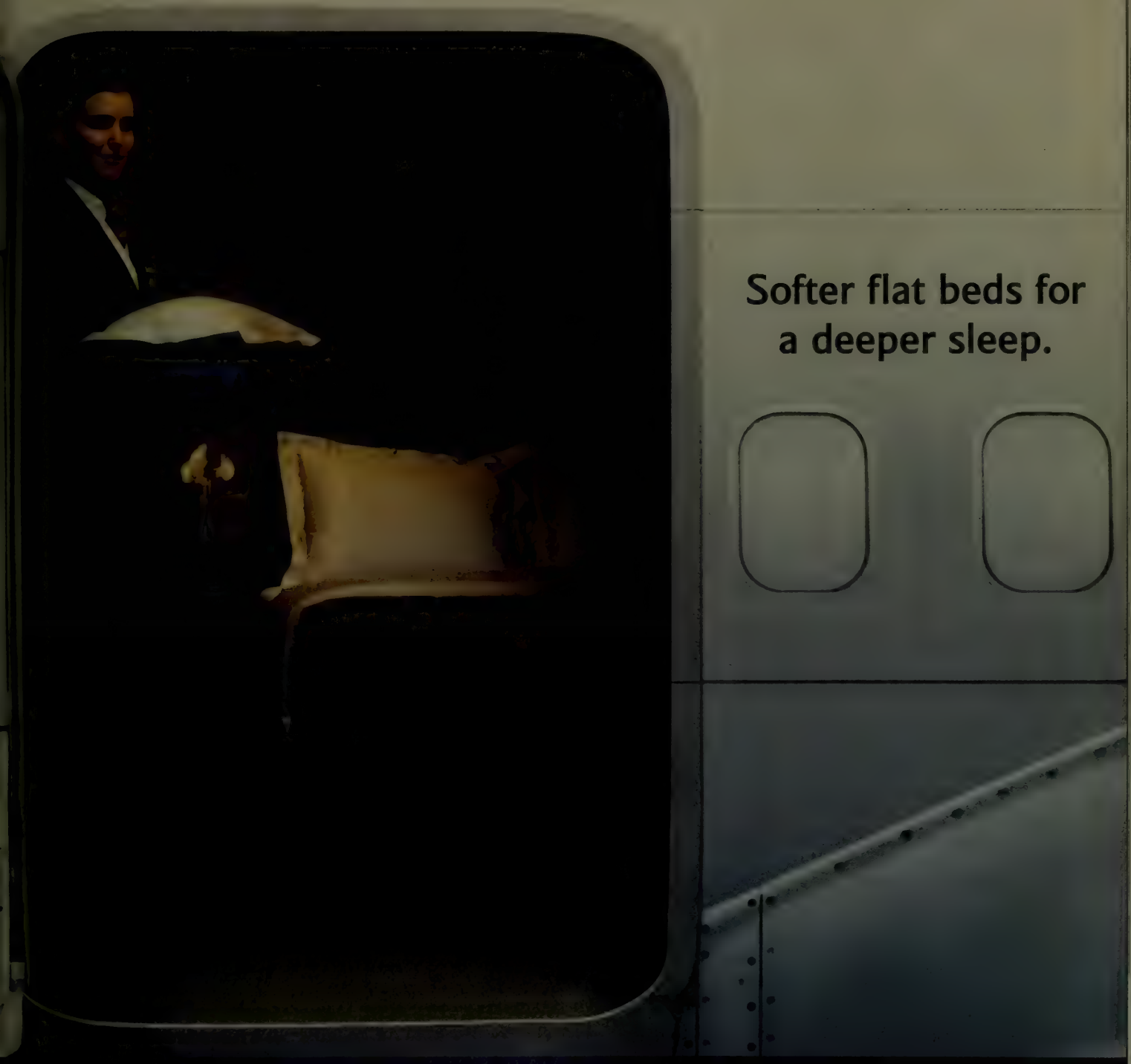
OFFICE LIVE OFFERS a similarly wide array of services, aimed at small businesses. Microsoft will provide the software for designing Web sites and the computing capacity to run them for free. It will also give away Web-based applications to manage businesses, such as collaboration programs. The company hopes to pay for that basic level of service with ad sales. Users can subscribe to additional applications, such as project management, f a fee. And the services link to Office so ware programs such as Outlook so th users can work both online and off.

Microsoft's revenues from the ne businesses will be largely advertisin driven—mimicking Google. "Google h done an amazing job of getting that ad e gine to click on all eig cylinders," says Microso Chief Technology Offic Ray Ozzie, the Lotus Not creator who joined M crosoft in April and leading the compan software-as-a-servi charge. For Microsoft succeed, it will have prove to advertisers that can provide laser-target advertising. Only the "they'll be able to get a vertising to subsidize ser ices and software," sa Tim Hanlon, director emerging contacts at Sta com MediaVest Group, media buying agency.

The strategy is as ris as it is bold. Microsof new online offerings w inevitably pull W surfers—and ad dollars away from its long-esta lished MSN Internet po tal. While the compa isn't yet offering an onli word-processing applic tion, Ozzie says it is loo ing at the possibility. Th could ultimately dra business away from its tr ditional Office softwa products. And most worrisome: The cr ation of a new Web-based ecosystem f software developers threatens to unde mine the one built around its Windov operating system. "We're going to have take some risks," acknowledges Ozzie.

That may be some of the most impo tant news of all to come from the a nouncement. As the company has grow into a $39.8 billion behemoth, it has f cused much of its efforts on defending i old empires, rather than building ne ones. The announcement of the Live fa ily of products may signal the dawn of new—and livelier—era at Microsoft. ■

–With Steve Hamm in New Yo



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COMPUTERS

DELL'S EDGE IS GETTING DULLER

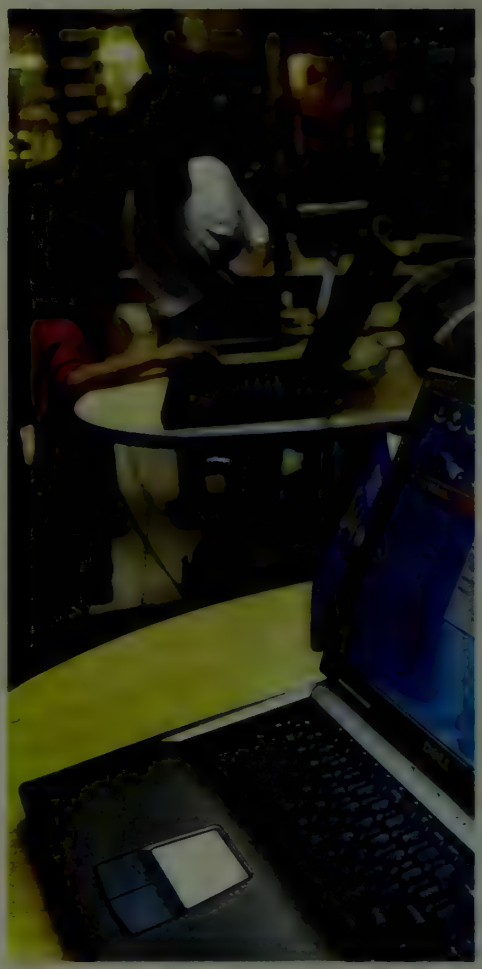
The PC maker isn't luring consumers the way it used to

BY LOUISE LEE AND PETER BURROWS

WHEN DELL INC. announced disappointing quarterly sales a few months ago, CEO Kevin B. Rollins explained away the problems as an "execution issue." But if investors were worried then, the company's Oct. 31 news that it would miss the mark again this quarter is prompting some to ask a question that once seemed unthinkable: Is the much-feared Dell Way running out of gas?

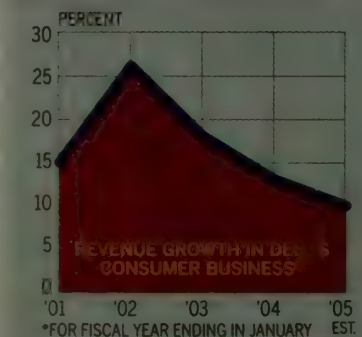
It could well be. While Dell still dominates PC-related gear sold to corporations, it's stumbling in its efforts to sell to consumers—a critical growth segment that has helped power brisk PC sales in recent quarters. At the same time, resurgent rivals such as Hewlett-Packard Co. and Gateway Inc. are pricing their products more aggressively and taking advantage of being in thousands of retail stores—unlike direct-selling Dell. "Dell traditionally has led with the lowest price," says FTN Midwest Securities Corp. analyst Bill Fearnley Jr. "Now it's not unusual to see even lower price points than Dell's."

The PC maker has always had mixed emotions about how to target consumers. While Dell focused all its guns on the corporate market, it reaped consumer sales opportunistically—never entering markets where it thought it couldn't achieve its profit goals, and quickly pulling money-losing products. For example, it still hasn't wholeheartedly targeted the vast Chinese consumer market, believing it too costly to court so many far-flung newbie customers.



MALL KIOSK Rival PC makers are ratcheting up the pressure

MISSING THE MARKET



Data: Dell Inc., FTN Midwest Securities Corp.

Such pragmatism is one reason for Dell's past success. Selling one computer to a consumer isn't nearly as profitable as signing a contract to sell thousands of PCs to a corporation. Churning out hits for today's tech-savvy consumers also requires design savvy and the ability to gamble on creating and marketing new features—both e pensive propositions. And selling to co sumers means investing in help desks hold customers' hands when their P melt down.

But the limitations of Dell's consum strategy are becoming clear. The Rou Rock (Tex.) company's consumer bu ness is expected to grow only 10% t year, to $8.4 billion, estimates FTN Mi west Securities, down from 13% last ye and 18% in 2003. And Dell's stock h fallen from about $40 per share in A gust to $29. Dell declined to comme citing the quiet period before its Nov. earnings call.

All this creates a major dilemma. maintain its status as a hot-growth co pany—it grew almost 19% in 2004 Dell needs to tap consumer PC deman which is expected to grow 8.4% ne year and 10% in 2007, according to r searcher IDC. Meanwhile, the corpora market is projected to grow 5.9% ne year and 7.8% in 2007. With revenu expected to hit about $55 billion in t fiscal year ending in January, Dell is no fighting the problem confronting large, maturing companies: how keep growing.

Can Dell avoid that fate? It faces uphill battle in righting its consum business. At least for now, Dell seems have run out of cost-cutting efficienci to enable it to underprice its riva enough to gain share and maintain ear ings at the same time. Analysts expe Rollins to mai tain Dell's botto line even if means losing cu tomers to lowe priced rivals. T goal: to stem eroding operating margi in its consumer business, which last ye fell to 5.2%, from 5.9% in '03.

Dell's rivals, meantime, can acce lower margins without disappointing i vestors. HP, for example is spending f more on research and developme Gateway, meanwhile, has fought its w back to profitability, despite low prices f its eMachines Inc. brand machines. A Lenovo plans to reenter the retail not book market, using the IBM ThinkPad acquired as part of its purchase of IBM PC business last year.

Dell has two choices, according Gartner Inc. analyst Charles Smulder "Follow the consumer market down pricing and adjust its costs according Or focus just on [business] products" a sacrifice market share and growth rate f profits. Wall Street will be watching. ■

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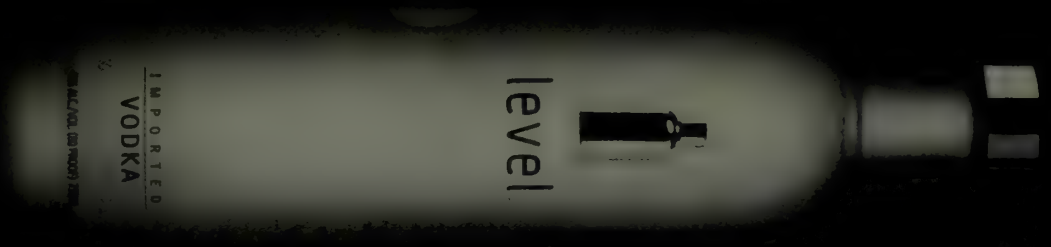

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THE SUPREME COURT

A BUSINESS KIND OF GUY

Executives like Alito's record on key issues

ALITO He seems to favor a restrained exercise of judicial power

BY LORRAINE WOELLERT

THE WORD IS OUT: U.S. Supreme Court nominee Samuel A. Alito Jr. roots for the Phillies, likes strong coffee, and has two attractive children. But what about his record? With 15 years on the bench and some 800 opinions to his credit, Alito's judicial philosophy is still largely unknown in many areas—including such critical business issues as tort reform and intellectual property, among others.

Now the U.S. Chamber of Commerce, corporate lawyers, and legal bloggers are hot on the trail. The night before Bush nominated Alito, University of Illinois College of Law professor Larry Ribstein posted a brief summary of 13 of the judge's most important corporate cases on Ideoblog. Since then, specialized Web logs on antitrust, free speech, and other key issues have contributed to the ever-growing body of Alito analysis. So far, he is winning positive reviews from the boardroom set, which is impressed by his precise reasoning and restrained exercise of judicial power. Alito sits on the Third Circuit Court of Appeals, based in Philadelphia, so he has heard plenty of commercial disputes originating in Corporate America's home state of Delaware and heavily industrialized Pennsylvania and New Jersey. Here's where he stands on some crucial business concerns.

	WHY BUSINESS CARES	ALITO'S POSITION	FOR MORE INFORMATION
TORT LIABILITY	High damage awards and chronic class-action litigation have dogged business for decades. Companies have spent years—and millions of dollars—in a largely frustrated attempt to get help in Congress. They would love an assist from the Supreme Court.	Alito gives business reason for optimism. He has voted at least twice to limit corporate liability. Alito scored with business in 1999, for example, by reversing a $4.37 million punitive damage award—in part because the plaintiff had no actual losses.	Professor Ribstein's broad analysis on Ideoblog (busmovie.typepad.com/ideoblog) covers tort reform and many other issues.
COMMERCIAL SPEECH	Can the Food & Drug Administration regulate what health claims food companies make about organic veggies? This type of issue hinges on the scope of of commercial free speech.	He believes that companies should have broad ability to promote their products and participate in important public policy debates.	The First Amendment Center (www.firstamendmentcenter.org) has a detailed analysis of Alito's free speech jurisprudence.
INTELLECTUAL PROPERTY	In the Information Economy, where wealth is rooted more in ideas than in factories, Supreme Court rulings in patent, trademark, and copyright law can make or break a company.	He won praise for his mastery of the complex legal and technological issues in the 2001 case *Southco Inc. v. Kanebridge Corp.*, siding against the copyright owner.	Check out the Patry Copyright blog, written by intellectual-property specialist William Patry (williampatry.blogspot.com).
SECURITIES LITIGATION	Settlements in shareholder lawsuits have cost business $25.4 billion since 1995, the Chamber of Commerce reports, and settlements keep getting bigger.	The judge is no knee-jerk probusiness vote in securities cases. He has ruled in favor of plaintiffs' lawyers in cases involving American Home Products and Burlington Coat Factory.	Temple University law professor David Hoffman provides a nice analysis at Concurring Opinions (www.concurringopinions.com).
WORKPLACE ISSUES	When general counsel reach for the Excedrin, it's often because of employment lawsuits. Think age discrimination, sexual harassment, and the Americans with Disabilities Act.	Workers, forget about getting much sympathy from this judge. Alito is in lockstep with business when it comes to curbing employee protections.	The American Progress Action Fund offers a liberal critique of Alito's employment-law rulings (www.americanprogressaction.org).

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SCIONS

DEAR ABBY, WHAT HAPPENED?

It's no longer apparent that the boss's daughter is the heir at Fidelity

BY AARON PRESSMAN

IS ABIGAIL P. JOHNSON up to the job of running fund giant Fidelity Investments someday? Her father, Chairman and CEO Edward C. Johnson III, may have already decided that she isn't. ¶ Abby confirmed to *BusinessWeek* that she fought with her father about an extensive overhaul of the $1 trillion mutual-fund group that she ran until May before she was moved to the much lower profile benefits unit. She acknowledged she didn't want to leave the fund unit. In a statement she said: "There's always one more thing you want to do at your old job. But I can't complain. I have been given one of the great assignments at Fidelity." Fidelity insists that the switch was to broaden her experience.

For his part, Ned Johnson says conflicts over strategy are nothing new. His father, Fidelity's founder, encouraged "spirited differences of opinion, but ultimately leading to the growth of Fidelity," Ned said in a statement. "That belief in constructive debate exists today." Abby seconded those thoughts.

Ned won this argument. In May he initiated a raft of changes in the way Fidelity's mutual funds will be run. He put people who had never managed stock funds at the top of the unit and eased out the longtime managers of two of Fidelity's biggest funds. Robert E. Stansky, who manages the $52 billion Magellan Fund and has not beaten the market since 2001, will retire. Instead of promoting an up-and-comer, Ned handed the reins to Harry W. Lange, 53, one of the firm's oldest managers.

Ned also departed from two traditional Fidelity practices: hiring only analysts right out of school and training them, and having a single manager in charge of most funds. Instead, it's hiring experienced outsiders, and some funds are split between two managers. Eric M. Kobren, president of Kobren Insight Group in Wellesley, Mass., a longtime Fidelity watcher, says Abby never could have made the recent personnel moves. "Abby grew up with these people. It's very difficult to ask her to make these changes."

A MIXED BAG

BY CONTRAST, Ned, 75, has always put performance above loyalty. He has been quick to dump veteran executives when he judged they were no longer up to snuff. This may be another problem for Abby, 43. Her performance at the family firm has been mixed. As a fund mana in the mid-'90s, she saw two of her fu do well, but one did poorly. After she t over all the mutual funds in 2001, the uity funds faltered; in 2002 they beat 6 of their peers, but in 2004 that was do to 50%. (However, the much sma bond-fund operation beat 80% of pee

Ned needed to act. Although Fidelit still the biggest mutual-fund company, inflows, at $3.4 billion for the first n months of the year, have fallen behind rivals American Funds and Vangu Group and smaller firms such as T. Ro Price Group and Dodge & Cox. Worse Fidelity's reputation for avoiding ma scandals came to an abrupt end on Abb watch. Company trad are under investigati by the Securities & change Commission a the U.S. Attorney's off in Boston for allege accepting gifts for ste ing orders to brokers. delity disciplined traders last year and re signed the unit's he The company says t fund shareholders w not affected by traders' conduct.

ABIGAIL JOHNSON She concedes there was a fight about mutual func

Abby may still have time to prove h self. Insiders say they see no sign of Ne slowing down and figure he could rem at the helm for five years. "I have no i mediate plans to retire and, therefore have not named my successor," Ned sa "If I am unable to select my successor, delity has a process in place to make t selection, but [it] has not been made."

The company has a cadre of strong ecutives. Brokerage chief Ellyn A. McC gan, 51, used aggressive price cuts and quisitions to gain market share. Ch Operating Officer Robert L. Reynolds, built the firm's 401(k) business fr nothing to market leader. Either could the top job if Abby is passed over or cides she doesn't want it. At Fideli blood may not be thicker than water.

Abby's Report Card

PORTFOLIO MANAGER
Handily beat comparable S&P indexes with two of the U.S. stock funds she ran in the mid-'90s but lagged far behind with a third.

B

MUTUAL FUND GROUP
Stock funds' long-term returns fell to the middle of the pack, though much smaller bond funds continued to shine.

C-

BENEFIT PLANS
In charge of the operation since May, she has focused on working out kinks with big clients rather than winning new ones.

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EDITED BY MONICA GAGNIER

HEADLINER

RONALD DOLLENS

BLOCKED EXIT

Looks like Ronald Dollens is going to be working longer than he had planned. On Nov. 2 the Federal Trade Commission, after nearly 11 months of review, conditionally approved Johnson & Johnson's $25.4 billion takeover of cardiac implant maker Guidant. With the O.K., Guidant CEO Dollens, 58, seemed on the verge of retiring, something he had hoped to do since mid-2004. But minutes after the FTC's action, J&J repudiated the deal, saying that a series of recalls by Guidant for defective defibrillators earlier this year materially damaged the Indianapolis company.

Still, Dollens has options. He could sue J&J to force it to complete the acquisition at $76 a share. Or he could look around for another bidder. Although the product recalls did cut into Guidant's share in the market for implantable devices, analysts say Abbott Laboratories and Merck may be interested in Guidant at the right price. Either way, the company will have to put off that retirement party for its founder. *–Michael Arndt*

DOWNSHIFTING IN DETROIT

Detroit's auto makers hit yet another pothole, as October proved the worst month for U.S. vehicle sales since 1998. **General Motors** and **Ford Motor** each reported that sales dropped by 26% from October, 2004. Buyers weren't tempted by new models since many made their purchases in previous months, when deep discounts were still in effect. They also steered clear of gas-guzzling sport-utility vehicles and trucks. **Chrysler Group's** news wasn't as bad: Its sales slowed 3.1%. Meanwhile, **Toyota Motor** and **Honda Motor** rode hot new models to modest sales gains, giving the Asians 40% of the U.S. market for the first time, while the Big Three held just 52.4%, a new low.

TIME WARNER'S NEW TEMPO

Time Warner CEO Richard Parsons is a conciliator *par excellence*. On Nov. 2 he announced Time Warner would boost its share repurchase plan from $5 billion to $12.5 billion, a nod to activist shareholder Carl Icahn's campaign to raise the buyback to $20 billion. What's more, Parsons announced that the media giant's net profit rose 80% in the third quarter, due largely to a strong performance at its cable unit. He also confirmed that Time Warner is in exploratory talks with potential partners for its **America Online** division.

The news came on the heels of the resignation of AOL co-founder Steve Case from the Time Warner board on Oct. 31. Case is leaving to pursue his new health and wellness business, **Revolution.** A lightning rod ever since the ill-fated merger of AOL and Time Warner in 2001, Case stepped down as chairman of the combined entity under shareholder pressure in 2003.

MERCURY IN RETROGRADE

Anthony Zingale was promoted to CEO of business software company **Mercury Interactive** from president in the wake of a scandal involving employee stock options. The Mountain View (Calif.)-based company said an internal investigation found that former CEO Amnon Landan and two other executives allegedly participated in a scheme to misreport option grant dates between 1996 and 2002. This allowed management and employees to exercise options at lower strike prices, thus pocketing more money, the report said. The internal probe follows a 2004 Securities & Exchange Commission inquiry. Landan could not be reached for comment. Mercury shares plunged 27% on the news.

JOINING THE WIRELESS ACT

Comcast, Time Warner Cable, Cox Communications, and **Advance/Newhouse Communications** unveiled a much-anticipated plan on Nov. 2 to pitch wireless service through **Sprint Nextel.** By mid-2006, all the members of the consortium will launch mobile phones in their respective regions. The new phones will allow subscribers to view live TV shows, program a digital videorecorder, manage PC e-mail, retrieve voice mail left on home phones, and, of course, talk.

ET CETERA...

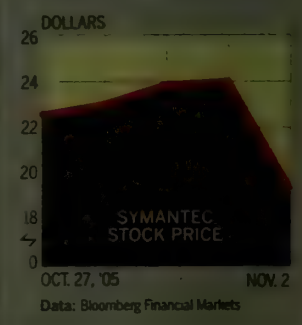
>> **Cablevision Systems'** board approved a $3 billion special shareholder dividend.

>> **Qwest Communications** will pay $400 million to settle a shareholder suit over accounting.

>> **Procter & Gamble's** quarterly profits rose 4%.

CLOSING BELL

Symantec shares fell 19.3%, to $19.37 on Nov. 2 after the security software giant warned investors that it would miss 2006 revenue and earnings targets. Two major reasons for the shortfall: tough retail competition and late shipment of key products.



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DITED BY RICHARD S. DUNHAM

s It Still The Grand Oil Party?

HEN IT COMES TO HAVING A NOSE for changing political winds in Vashington, your prototypical oil industry CEO bears an uncanny esemblance to Alfred E. Neuman. Only a week after two normal- reliable and pliant Republicans—House Speaker J. Dennis Iastert (Ill.) and Senate Majority Leader Bill Frist enn.)—leveled rhetorical broadsides at g Oil for record third-quarter profits, sky-gh prices, and failure to commit to new fineries, many energy executives are ushing aside the barbs as mere cover-ur-tail rhetoric from fretful friends. After , Republicans received more than $20 illion from energy interests in the last ection, and the two oilmen who run the hite House have never gotten tough with eir political benefactors. So you can un-rstand why Big Oil's response to Repub-an potshots is: What, me worry?

"This is more an image thing than a sub-ance thing," says one industry lobbyist. deed, an internal ExxonMobil document tained by *BusinessWeek* gues that the company's ofits are reasonable—far ore so than the financial dustry; that prices are iven by supply and de-and; and that Congress ould "pause" before do-g anything dramatic.

But with voters seething er energy prices and GOP aders under an ethical oud, Republicans up ainst a political wall ight, for the first time, take tion against an industry at funnels 80% of its polit-l contributions their way. Iouse Republicans have acted" by giving e industry tax breaks, Hastert says. "Now e oil companies need to do their part."

Energy leaders will run into a PR buzz w on Nov. 8 when Senate Republicans ld hearings on energy prices. Scheduled face pointed questions: Exxon Mobil CEO ee Raymond, ConocoPhillips CEO Jim ulva, and John Hofmeister, president of oyal Dutch/Shell Group's U.S. operation. 'hey don't know what's going to hit them," says one oil lobbyist. "They're not going to have one friend up there.... You can't go reporting record profits and explain it away as supply and demand." The same lobbyist says he's reminding clients of the fate of Big Tobacco, a once-powerful force on the Hill. "The message to these guys is, 'The American public thinks you are evil.'"

Windfall Profits Tax

HASTERT, WHOSE ILLINOIS constituents are shivering at the prospect of soaring winter heating costs, is trying to pressure Big Oil to build new refineries, and threatening to probe price-gouging charges. And Senate Finance Committee Chairman Charles E. Grassley (R-Iowa) wants energy companies to exhibit "good corporate citizenship" by donating cash to help the poor cope with heating bills.

GRASSLEY Urging oil interests to help the poor with oil bills

Is Big Oil about to be subjected to the kind of mau-mau-ing that is forcing Wal-Mart to make concessions to critics? Perhaps. Some Republicans, for example, are talking openly about a one-time increase in the royalty fees companies pay to extract oil from federal lands. And Senators Judd Gregg (R-N.H.) and Susan Collins (R-Me.) are calling for a windfall profits tax, a pet idea of Hill Dems.

Bottom line: The politics of oil has changed fundamentally. An Oct. 12-24 Pew Research Center poll found that oil companies, never high atop the corporate hit parade, have reached an all-time ratings low with the public: Only 20% have a favorable impression. With support for the Republican Congress dipping below 30%, the party leadership seems serious about opening up some distance from its longtime oil-patch allies. ■

–By Eamon Javers

CAPITAL INSIDER

GODSPEED, MR. OXLEY. NOW LET'S PARTY

HOUSE FINANCIAL Services Committee Chairman Michael Oxley's Nov. 1 retirement announcement gives a boost to business-led efforts to rein in the corporate-governance legislation that bears his name. Companies complain about compliance costs and say the Sarbanes-Oxley law gives government enforcers too much leverage in probes of corporate wrongdoing.

GOP leaders were never keen on the get-tough 2002 law, designed to defuse public anger at corporate scandals. But they felt a political imperative to do something to show they cared about crime in the suites.

Now, with co-authors Oxley (R-Ohio) and Senator Paul Sarbanes (D-Md.) retiring in 2006, business lobbyists should have a good chance to water down "SOX" in the 2007 session of Congress. "Time to repeal Sarbanes-Oxley!" exults one GOP staffer.

Meanwhile, Oxley's news has set off a spirited succession struggle for control of a committee closely watched by Wall Street. The contenders most likely to get the gavel represent different approaches to business. Representative Richard Baker (R-La.), chair of the capital markets subcommittee and a close Oxley ally, is an occasional thorn in Wall Street's side. He's the driving force behind reforming Fannie Mae and Freddie Mac. Many corporate reps are lining up behind financial institutions subcommittee chair Spencer Bachus (R-Ala.), who has won kudos from business for his work on regulatory relief and deposit insurance reform. Bachus also has strong support from the GOP leadership.

–By Eamon Javers and Amy Borrus

HOT SICHUAN
Nightlife in thriving Chengdu

CHINA

GO WEST, WESTERNERS

With growth slowing in the crowded and costly coastal centers, Beijing is ushering investors into the hinterland

BY DEXTER ROBERTS

IT WAS A CHINESE-STYLE ROAD show: In a sumptuous banquet hall in south Beijing, executives from a long list of multinationals, including Boeing, Caterpillar, Goodyear, Alcoa, Unisys, and Microsoft, sipped cocktails and dined on such Sichuan delicacies as twice-cooked pork, diced duck with pepper on pastry shells, and dan-dan noodles. Their hosts for the Oct. 26 event were a delegation of top officials from Sichuan, a western province 1,200 miles from Beijing that is eager to lure investment away from China's coastal cities.

The Sichuan officials had much to offer. A manufacturing worker there earns an average of $126 a month, a little more than half what he might make in Guangzhou or Shanghai. There's also abundant energy, brand new highways and power grids, and a vast interior market. "We sincerely hope that multinational corporations can take an active part in the development of Sichuan," local Communist Party Secretary Zhang Xuezhong intoned over repeated toasts of rice liquor and Chinese red wine.

Two years after President Hu Jintao and Premier Wen Jiabao placed urgent priority on developing China's hinterlands, China's bureaucrats have unleashed a charm offensive to persuade companies to move inland. Anxious about a rising tide of industrial and farmer protests in central and western China, Beijing is giving top billing to narrowing the yawning income gap between rich coastal cities and the rest of t country. Billions of dollars have been spe on bridges, expressways, and power plar to boost the economies of inland Chir Now provincial delegations increasing are trekking to Beijing, Shanghai, a Guangzhou to trumpet their edge over t coast. "In Sichuan, we provide year-rou reliable energy for investors—we do have the problems of the Yangtze Riv Delta," bragged Xu Mengjia, the mayor Yaan, one of five Sichuan mayors who a tended the Beijing coming-out party.

LOOKING FOR LABOR?

THESE DAYS those mayors have an i creasingly easy sell with multinationa and local companies alike. After years easy expansion, coastal China is faci

rowing pains. Labor and land costs are sing fast in Shanghai, with commercial ents up close to 40% over the last three ears, while industrial space is simply not vailable. Labor costs are inching up in uangdong too, though a bigger problem finding any workers at all for its huge anufacturing sector. "The operating nvironment in coastal areas is getting orse and worse," says Zhai Suoling, eneral manager of a toy factory in ongguan. "Lots of manufacturers are oving to inland cities."

Companies including General Motors, onda, Intel, and Motorola now run oprations in interior provinces. They report o shortage of skilled labor—and increasgly vibrant consumer markets. "Comanies that don't look at inland China will nd themselves disadvantaged," says mory Williams, chairman of the Ameri-an Chamber of Commerce in Beijing, hich reports that 50% of U.S. member ompanies have already invested in secnd-tier cities. Amcham-organized deleations, including executives from hevron, Rockwell Automation Inc., and hio-based manufacturer Eaton, recently outed new investment opportunities in injiang, whose capital Urumqi is 1,500 iles from Beijing, as well as Inner Monolia and Yunnan, which borders Vietam. "When I talk to manufacturers, they y they will never build another plant in hanghai—it's too expensive," says ichael Hart, Shanghai-based head of reater China research for real estate onsultancy Jones Lang Lasalle.

Moving west is ow easier than ver due to the assive buildout f interior infraructure. Almost $9 billion has been pent on new interior airports alone in e last five years. A recently approved lan will double the 20,000-mile highway etwork—already the world's second ost extensive after the U.S. interstate ystem. "When the Chinese government lks about building infrastructure, they ill do it on time and on a scale that des belief," says one Shanghai-based Vestern logistics expert.

Not surprisingly, managers of busiesses with cutthroat margins, like toys nd shoes, have been the first to migrate. ake Taiwan native Zhai, whose factories n Guangdong province build wooden ollhouses and toy wagons that sell in tores like Wal-Mart Stores Inc. and mart Corp. Last year he built a $2 milon factory in Tonggu, Jiangxi, where 00 workers make wooden toy pieces that are then trucked 12 hours to his Guangdong factory for assembly. When a new road opens next year, transit time will drop to nine hours. With land 50% cheaper in Jiangxi, and energy and water 25% less, the move was a no-brainer, Zhai says. Workers in his new factory are also paid a little less, but more important to Zhai is the low turnover—close to zero in Jiangxi vs. 40% in Guangdong. "Having a stable labor force and smooth operation is key to my business," Zhai says. "I plan to move more and more production out of Dongguan."

Industries with narrow margins are leading the trek into the interior

Even deep in China's hinterlands some cities are succeeding in wooing foreign investment, including high-tech industries that can utilize air freight to transport products and the Internet for logistics. Sichuan province has pulled in more than $6 billion in investment from the likes of Toyota Motor, hypermarket chain Carrefour, and French cement maker Lafarge. In the provincial capital of Chengdu (population: 10 million), streets are lined with Audi and Buick dealerships and boutiques for luxury goods by Louis Vuitton and Gucci.

Chengdu was an early beneficiary of the Go West movement: It nabbed a Motorola Inc. research and development lab in 2001 by promoting lower costs as well as access to engineers from its strong universities. When Motorola decided to expand outside its original downtown location in 2003, the municipal government agreed to pay for the new research center. (Neither the company nor Chengdu officials will say how much.) Inside, some 330 Chinese technicians are developing software for Motorola phones. Since Motorola arrived in Chengdu, Alcatel, Ericsson, Nokia, and Microsoft have all set up R&D or tech centers in the sleek industrial parks that skirt the city.

TECH HUB A digital-TV factory goes up in Chengdu

'RESULTS-ORIENTED'

FOR MANY MANUFACTURERS, the market is right outside their door. Intel Corp. justifies the $450 million it is spending on two assembly plants for chipsets in Chengdu by pointing out that computer sales in the region are growing by 45% a year. Boise (Idaho)-based semiconductor maker Micron Electronics Inc. has just announced it will sink $250 million into a new plant in the ancient city of Xian in the neighboring province of Shaanxi. "Both cities have very young and energetic, ambitious, results-oriented politicians," says Ian Yang, Asia Pacific general manager for Intel.

What about coastal China? Foreign investment there still dwarfs what is going on in western China. And regardless of any cost savings, multinationals want their regional headquarters near the political and financial centers of Beijing and Shanghai. Nevertheless, it is clear that vast new regions of China are now open for business, or soon will be. The next round of banquets sponsored by officials from areas like Sichuan are sure to be well attended. ■

Bargain Workers

Monthly salaries in interior cities like Chengdu are substantially lower

JOB	CHENGDU	SHANGHAI	BEIJING
Worker	$126	$210	$211
Technician	213	493	298
Dept. Manager	376	1264	1370
Sr. Manager	678	2034	2512

Data: Sichuan Provincial Government

FACE OFF Safety isn't cheap. Will consumers pay?

AUTO MAKERS

CARS THAT BRAKE WHEN YOU DON'T

Japan leads the way in high-tech gadgets that help prevent accidents

BY IAN ROWLEY

IT'S NOT JUST THE SNAZZY PAINT job that tells you the Honda ASV-3 prototype is no ordinary version of the Accord sedan. Five years in the making, the ASV-3 is crammed with as many gizmos as a fighter jet, including navigation systems, radar, and infrared cameras.

This is Honda Motor Co.'s Advanced Safety Vehicle, and the gadgetry is all about avoiding accidents. Turn that corner too quickly and the ASV-3 uses satellite technology to calculate the optimum speed, and applies the brakes accordingly. If you're about to drive into a collision at an intersection, a radio signal alerts the onboard computer and sets off an alarm. If a collision can't be avoided, data including the driver's heart rate and respiratory condition are transmitted to emergency personnel. "The ASV-3 offers the prospect of safer, more comfortable, worry-free driving," says Akihiro Kubo, executive chief engineer at Honda's research and development center in Tochigi.

In mid-October, Japanese carmakers gathered in Hokkaido to show off their latest safety gadgets, which they had been testing on Japan's northern island. The technologies used in the ASV-3 and other vehicles are not yet in mass production, and may not be for years. But such bells and whistles put an exclamation point on Japan's growing leadership in the field. All carmakers do safety research, but "it's the likes of Honda and Toyota that are getting them out there and into cars," says Andrew Phillips, an analyst at Nikko Citigroup in Tokyo.

High-tech safety equipment began making its way into automobiles about five years ago. In February, 2003, Toyota introduced a safety system into the Harrier SUV, the Japanese version of the Lexus RX 330, that uses radar technology to warn drivers if a collision is likely. Now it has been upgraded so that if a driver fails to react to a dangerous situation, the precrash safety system sets off an alarm, tightens the seat belt to get the driver's attention, or applies the brakes. "The ultimate aim is to c ate a car that ca not crash," s Shiro Monza general manager of Toyota Motor's ve cle control system engineering depa ment in Shizuoka.

Honda is also upgrading existing sa ty features. A night vision system on Legend luxury sedan projects on a scre above the dashboard infrared images hard-to-see pedestrians who cross front of your car in the dark. Not to outdone, Mazda Motor Corp. has a dev on its new MPV minivan that automa cally moves headlights from side-to-si to avoid blinding oncoming drivers night. And Nissan, which pledges to by half the number of deaths and serio injuries suffered in its vehicles by 2015 working on equipment that enables sp cially equipped traffic lights to commu cate with vehicles—to tell them, for stance, if they are approaching a scho "If you don't have your fundamentals safety right, you can't compete," Niss CEO Carlos Ghosn says. "We're maki sure we're at the top level."

Turning prototypes like the Hon ASV-3 into reality for most drivers wo be easy. Engineers expect the rollout vehicle-to-vehicle communication to ta until 2010. One issue is cost. Most of t new safety gear is only being added top-end models. It's too expensive fo run-of-the-mill car. Toyota's newest sa ty system—including air bags and radar-controlled cruise control system costs $4,300. Shoji Shiraishi, a partner Bain & Co. in Tokyo, reckons each safe option will need to be available for as l tle as $100 before becomes standa "Many custome are not ready to p much for extra sa ty features," he sa

There is also t question of w takes legal respon bility for accider involving vehicl equipped with sa ty devices. Every a tomobile make worst nightmare that it will intr duce advanced sa ty equipment, or to be sued by dri ers who hold it sponsible when accident happe anyway. ■

Crash Course in Vehicle Safety

CARS THAT TALK TO EACH OTHER
Toyota and Honda are testing radio links that let vehicles communicate.

PROTECTING PEDESTRIANS
Mazda is working on radar and cameras that detect pedestrians in the road.

AIR BAGS FOR MOTORCYCLES
Honda has developed an air bag for motorbikes that inflates just 0.15 seconds after a collision.

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alk with your doctor first. Make sure you are healthy enough to have sex. If you have chest ain, nausea, or other discomforts during sex, seek medical help right away. Although erections asting for more than four hours may occur rarely with all ED treatments in this drug class, is important to seek immediate medical attention. Erections lasting longer than six hours an result in long-term loss of potency.

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This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?
VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body
When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works
VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone
As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do
- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV — the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA
Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have ever had severe vision loss
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines
Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You
VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA
Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects
Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose
In case of accidental overdose, call your doctor right away.

• Storing VIAGRA
Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA
VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

Pfizer U.S. Pharmaceuticals

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TELECOM

CELL PHONES FOR THE PEOPLE

Developing nations can be gold mines for mobile companies that go downscale

BY ANDY REINHARDT

IN MOBILE PHONES, THE stars of the moment are multimedia wonders like the new Razr V3x from Motorola Inc. and Nokia Corp.'s top-of-the-line N-90 camera phone with Carl Zeiss optics. Yet for all the attention they grab, these pricey gizmos are a sliver of the 800 million unit-per-year mobile-phone business.

Increasingly, the real action is at the unglamorous end of the scale, among bare-bones Nokia and Motorola models priced under $50. Sales of such phones, which often handle just voice and text messaging, could grow 100% annually for the next five years.

There are now about 2 billion mobile-phone users in the world, and market penetration is above 50% in advanced countries. But as prices for phones and service drop, another billion customers could sign up by 2010 from places such as China, India, Brazil, and Russia. "All the growth in subscribers is coming from emerging markets," says David Taylor, Motorola's director of strategy and operations for high-growth markets.

For now, the only serious contenders in this segment are Nokia and Motorola. As the world's No. 1 and No. 2 makers, respectively, they're the only companies able to churn out ultracheap phones with the features, quality, and brand names customers want. "This market is suited to mega-vendors with economies of scale," says senior analyst Neil Mawston with researcher Strategy Analytics, near London. Samsung Group, LG Electronics, and Sony Ericsson Mobile Communications haven't yet announced plans to sell sub-$50 handsets, preferring to rake in rich profits at the high end. That strategy could backfire, though, as the market shifts.

Emerging low-cost Chinese makers have a different problem: Their volumes aren't high enough to match the efficiencies enjoyed by Nokia and Motorola, so they lose money on rock-bottom handsets. Also, they're not as adept at shrinking electronics and producing durable packages. Plus, status-conscious buyers in the Third World turn up their noses at unknown marques. "Brazilians want brand names and are willing to pay a bit more for Nokia and Motorola," says Sérgio Pelegrino, director of GSM for Brasil Telecom.

Of course, moving downscale also poses risks. On Oct. 20, Nokia reported it sold 15 million entry-level 1100 series handsets in the third quarter alone. But despite an overall 29% jump in net profits, Wall Street was spooked by a 5.6% year-over-year decline in Nokia's average selling price, to $122.40, and drove shares down 4.5%. Analyst Albert Lin with American Technology Research Inc. in San Francisco thinks investors underestimate Nokia's ability to prosper in the low-price segment: "These phones can actually have higher margins than high-end models."

GOOD MORNING, VIETNAM Growth will come from emerging nations

Bargain Battle

Motorola and Nokia are pitching ultra-low-cost phones at emerging markets

MOTOROLA has won bids to deliver up to 12 million handsets, from South Africa to Bangladesh. The model C113A handles voice and text and will cost just $40 wholesale, before taxes. Goodies include a ringtone composer, games, currency converter, and calculator.

NOKIA sold 15 million of its 1100 series phones in the third quarter alone. The simple voice-and-text handsets retail for about $60, after tax. The new 1110 has games and ringtones and, for illiterate users, a speaking alarm clock and iconic address book.

Data: Company reports

BARGAIN SERVICE

ALREADY, BOTH Nokia and Motorola are making models for as little as $25, allowing gross margins of 15% to 30% at current prices. That compares with overall 33% margins across Nokia's entire handset portfolio; Motorola doesn't disclose figures.

Big volumes of low-end phones also unleash scale economies that reduce costs even for high-end models. "It's a key factor in getting our cost structure down," says Antonio Torres, the director of business development and industry marketing for Nokia's business unit. As sales shift to low-end phones, such savings should help Nokia maintain overall operating margins of 13.5% for years, forecasts analyst Richard Windsor of Nomura Securities in London.

Nokia is also churning out technologies to slash the cost of building and operating wireless networks by a half. Bargain service boosts the impact of cheaper phones—and should help the 4 billion people on earth who have never made a phone call. ■

–With Elizabeth Johnson in São Paolo, Brazil

EDITED BY ROSE BRADY

Gridlock in Gaza Foils Economic Gains

WHEN ISRAEL COMPLETED ITS WITHDRAWAL from the Gaza Strip and the northern West Bank in September, the Palestinians and their backers hoped there would be immediate economic gains. Palestinian officials named economic development in Gaza and the West Bank as their top priority. International donors stood ready to contribute billions of dollars in aid and investment to the territories.

Those dividends have yet to materialize. After militants launched rockets from Gaza, Israel retaliated and clamped down. The Strip is more isolated than ever, and freedom of movement in the West Bank is limited. With legislative elections in January, President Mahmoud Abbas needs to show economic results to the Palestinian public if his Fatah movement is to win. In a recent survey by pollster Khalil Shikaki, for the first time a majority of Palestinians polled cited the economy as the top concern—even over ending Israeli occupation.

Halting Progress

OPTIMISTS HAD hoped for a surge in cross-border agricultural trade after Israel dismantled its Gaza settlements. That can't happen without an Israeli decision to allow freer movement of goods and people in Gaza and the West Bank. On Nov. 1, Israeli officials provisionally agreed to open a border crossing between Gaza and Egypt, provided it is monitored by international observers. Palestinians are also pushing for an end to restrictions on the more important border between Gaza and Israel in time for the harvest season.

ABBAS needs to show results before elections

The Israeli government is also weighing whether to establish an overland link between Gaza and the West Bank, which are separated by 50 kilometers of Israeli territory. While Vice-Premier Shimon Peres favors easier movement, the military is wary due to security concerns, and Prime Minister Ariel Sharon is backing the military. In mid-October, former World Bank President James D. Wolfensohn, now a Middle East envoy for "the Quartet" of the U.S., European Union, Russia, and the U.N., accused Israel of dragging its feet. Secretary of State Condoleezza Rice is expected to press the issue when she visits the region soon.

In the meantime, truck traffic carrying produce and textiles to Israel is down to a trickle. The World Bank says the number of trucks entering Israel must increase to at least 100 a day—five times the current level—for the Gaza economy to get back on track. "There will be only limited growth unless the border [is] opened to allow for the free movement of exports," says Palestinian Planning Minister Ghassan Al-Khatib. Per capita gross domestic product among Palestinians is down 50% since the *intifada* began in 2000, to $950 a year. Workers need to be able to travel, too. Some 50,000 Palestinians cross from the West Bank into Israel, down from 140,000 five years ago. Gazan workers have been barred from entering Israel since the disengagement.

For Abbas, there are two dangers. One is that he'll have little to show for his year as President. Then, the militant Hamas movement, which provides social services, could make big election gains. "Right now Hamas is doing more for the people of Gaza than the Palestinian Authority," says Edward S. Walker Jr., president of the Middle East Institute and former U.S. Ambassador to Israel. A bigger danger, adds Henry Siegman, a Middle East expert at the Council on Foreign Relations, is that "the *intifada* will return and be more violent than in the past." Steps to revive the Palestinian economy are urgently needed. ■

–By Neal Sandler in Jerusalem

WORLD WRAPUP

A HAWKISH SUCCESSOR FOR KOIZUMI?

ALREADY STRAINED Sino-Japanese ties took a turn for th worse after Japan's Oct. 31 Cabinet shake-up. Prime Minister **Junichiro Koizumi** named foreign policy hawk **Shinzo Abe,** 51, as Chief Cabine Secretary. The move positions the Liberal Democratic Party star as a likely successor to Koizumi, who is set to resign h seat in September, 2006. Abe, who regularly tops polls as a future premier, is a big backer of Japan's more assertive foreign policy and has criticize China for stirring up anti-Japanese sentiment. The Chinese press has jumped on the fact that Abe is the grandson of former Prime Minister **Nobusuke Kishi,** who served in the wartime government of **Hideki Tojo** and was convicted as a war criminal before making a comeback in the 1950s.

PROGRESS ON A MERKEL GOVERNMENT

DESPITE POLITICAL chaos in Berlin, the betting among pundits is that Christian Democrat **Angela Merkel** will sti cobble together a coalition German government with herself as Chancellor. The unexpected resignation on Oct. 31 o **Franz Müntefering,** chairman of the center-left Social Democrat (SPD), raised questions about the SPD's reliability as a partne But the two parties are making progress on issues such as givi states more policy-setting powe Merkel's influence may even have risen after **Edmund Stoiber,** fellow conservative but a rival, decided to remain Bavarian Prime Minister rather than become Economics Minister in Berlin. Still, she'll have her hands full keeping a grand coalition together.

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*Based on the fiscal year-end data available as of 9/30/05. The Retirement Funds' total expense ratios versus their Lipper category averages for individual investor funds are 0.63%, 0.67%, 0.71%, 0.74%, 0.76%, 0.79%, 0.79%, 0.79%, and 0.79% for the Retirement 2005, 2010, 2015, 2020, 2025, 2030, 2035, 2040, and 2045 Funds, respectively, versus 1.46% for the flexible portfolio funds category; and 0.56% for the Retirement Income Fund versus 1.14% for the income funds category. (Source for data: Lipper Inc.) T. Rowe Price Investment Services, Inc., Distributor.

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Listen: The Sound of Hope

Cochlear implants could be a boon for the deaf—and a booming business

BY BRUCE EINHORN

RAVI PANDIAN, A 43-YEAR-old geologist who lives in Highland Park, N.J., knows the exact moment he went deaf. An immigrant to the U.S. who grew up in India, he had suffered his first debilitating ear infection when he was six months old, and by 1991 had lost all hearing in his left ear. At 10:30 a.m. on Feb. 7, 2003, Pandian sensed something was wrong with his right ear, too. Within 30 minutes, his hearing was gone.

Pandian's case was complicated by a tumor on his eardrum and a botched childhood operation that had severed a nerve in his right ear. Starting in 2003, Pandian spent two years going from doctor to doctor, but nothing worked. "It was awful being deaf," he says. "Not to hear my son speak, not to hear his school band play." Finally, in February, 2005, he got a cochlear implant—a device that uses tiny electrodes to turn sounds picked up by an external microphone into electronic impulses. The implant then transmits those impulses to the brain via auditory nerves in the inner ear. After the doctor activated the device, Pandian could hear the words of his wife and son. He was struck by a cacophony—revolving doors, roaring buses, the tick-tock of the directional signal in his car. "I went in with no expectations and no hopes," he says. "I came o with tons of excitement for the future."

Manufacturers of cochlear implan which were introduced more than thr decades ago, are hoping such testimonia can finally help them reap major reward Only 17,000 people worldwide h cochlear devices implanted last year, yet the U.S. alone, some 900,000 people a believed to be deaf or near-deaf. One pro lem is that the implants may cost $25,00 and the surgery itself can run up an equa ly high tab. Cochlear Ltd. in Sydney, Au tralia, which provided Pandian's implan claims 70% of the market. Its two chief r vals are Advanced Bionics Corp. in Sylma Calif.—a unit of Boston Scientific Corp. and Med-El Corp. in Innsbruck, Austria

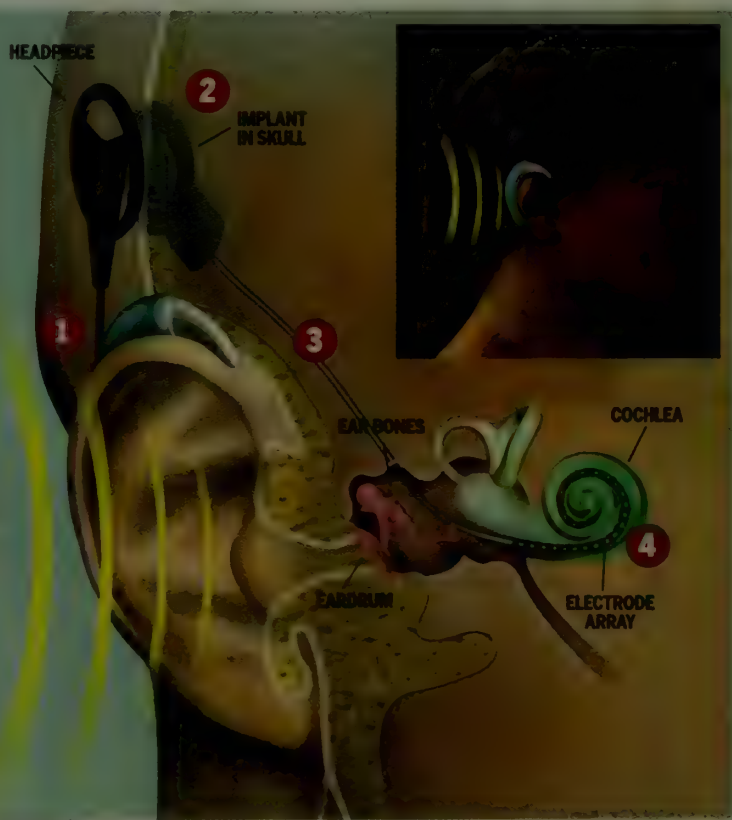
Many more hearing-impaired peop may seek implants as the technolo grows more powerful. The integrat electronic circuitry and software in t newest implants put the world's most s phisticated cell phones to shame, achie ing results that once seemed complete out of reach. Some patients testify th they can now stand in a crowded roo and carry on a conversation. Others r port that they can listen to music—som thing that, with earlier implants, sound like a series of hisses and squeaks.

Much of this magic is performed by t microcode embedded in the latest d vices. "The programming has leaped b yond imagination," says Dr. Darius K han, chief of the otolaryngology depa

Wired for Hearing

Ears perform minor miracles. They capture the movement of air molecules (sound waves) and transfer that information to the brain

HOW THE EAR WORKS: When sound waves strike the eardrum, it vibrates. That motion is passed along to tiny bones, then on to the fluid-filled inner ear, called the cochlea. There, delicate hair cells pick up the vibration and turn it into impulses that nerves carry to the brain, which interprets them as sound. Damage to the fragile hair cells is a common cause of deafness.



HOW A COCHLEAR IMPLANT CAN HELP:

1 A device behind the ear processes sounds into digital information and transmits it to a headpiece.

2 The headpiece, held in place by a magnet, relays the information to an implant in the skull.

3 The implant converts the information into electrical signals and sends them down fine wires to an array of electrodes in the inner ear.

4 The electrode array passes the signals on to a hearing nerve, which carries the sound information to the brain.

Cochlear

Who'd have thought that a natural fiber could help fight diabetes?

Well actually, we did.

You gotta love nature. Example: Cellulose fiber, the most abundant, renewable carbohydrate found in nature, can be used to help prevent diabetes. Dow METHOCEL™ dietary fiber is made from natural cellulose. In tests, Dow scientists and the USDA found that adding a few grams of METHOCEL™ to a high-fat diet slowed fat absorption, potentially reducing the development of insulin resistance – a precursor to Type II diabetes. The availability of METHOCEL™ in the foods we buy will make it easy to get the fiber we need. Cutting our fat and sugar intake wouldn't hurt either. See how Dow is using the right chemistry to help protect our health at dow.com.

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STANDARD
&POOR'S

ent at NYU-Brooklyn Hospital Center d Pandian's doctor. "This could potenlly eliminate deafness."

If Kohan is right, implants could beme a mainstream business. Cochlear is o betting that demographics are on its le. One out of every four Americans er 65 suffers some hearing loss. Tradinally, senior citizens have assumed that s you get older, you get deaf, and that's e way things are," says Neville Mitchell, chlear's chief financial officer. But by boomers "are less tolerant of disility," he says. "They're not prepared to t up with deafness."

EAFENING DEMOGRAPHICS

CHLEAR IS working hard to position itlf for a boomer bonanza. Chief Executive ris Roberts, a 52-year-old biomedical gineer, says the company is developing a nge of new treatments to address differt types of hearing problems. is includes hybrid devices at combine an implant with a aring aid, aimed at people th less severe hearing loss. at could expand the target tient population some 50 to times, Roberts believes.

The company is also broading its reach through partrships that would create mplementary products, as posed to devices that comte with implants. In 2003 it amed up with Switzerland's onak Group, a leading mak of hearing devices, to create plantable hearing aids. And st March, Cochlear paid $150 illion to acquire Entific Medal Systems, a Swedish comny that produces the world's p bone-anchored hearing d. It conveys sound through one rather than the middle r, for patients with malrmed ear canals. Beyond just implants, chlear is "going to be the hearing-loss mpany," says David Stanton, an analyst ABN Amro in Sydney.

Cochlear has deep roots in auditory scice. It was spun off from Australia's most stinguished hearing lab, the Bionic Ear stitute of Melbourne, in 1983, and it conues to maintain exclusive ties to that initution. Bionic researchers are aiding the mpany in one of its most urgent misons: figuring out how to preserve the agile hairs of the inner ear, which can be estroyed by infections or injuries.

For many partially deaf people, getting implant simply is not worth the risk of causing irreversible damage to hair cells that still function. New drug therapies and other techniques pioneered by the Melbourne scientists could help safeguard the hairs that are left, says R.K. Shepherd, acting director of the institute. Researchers at the institute are also boosting the capacity of cochlear implants, and even designing devices to implant in the central auditory pathway, bypassing the inner ear altogether.

Cochlear's competitors are trying to catch up to the industry giant with their own innovations. Advanced Bionics, which made the device implanted into talk-radio host Rush Limbaugh in 2002, had a setback last year when it had to recall some implants and temporarily halt production because of safety concerns. The company was acquired by Boston Scientific in June, 2004, for $742 million, and is now testing a new implant that the company says can provide five times as many combinations of sounds to the brain as existing models. "Cochlear may be No. 1 now, but that's going to change," vows Advanced Bionics President Jeff Greiner. Andrew Goodsall, an analyst at Citigroup Smith Barney in Sydney, says it's too early to draw conclusions.

CEO ROBERTS

Cochlear Ltd. is poised to exploit a boomer bonanza

Meanwhile, Cochlear is facing its own uncertainty: Two years ago, the U.S. Justice Dept. launched an inquiry into incentives the company offers to implant surgeons. Cochlear CEO Roberts argues that such investigations are routine and notes that there are no allegations. "They wanted documentation; we provided documentation. It's pretty common."

The leading cochlear implant makers face other risks. Some researchers in China and India are attempting to develop similar devices that would cost much less. So far, their work hasn't spawned any commercial products, and Cochlear officials say they're not worried. Patients who are getting devices inserted into their heads will always prefer to enlist a company with a proven track record, they insist.

In fact, Roberts predicts that current implant patients could end up being excellent repeat customers—they may opt to have devices in both their ears. He predicts that within a decade bilateral implants will be routine. If so, old age need no longer be a silent age. ■

–With William C. Symonds in Boston

"THE FRENCH MAY BE EXPERTS ON FOOD AND WINE, BUT WHAT CAN THEY TEACH US ABOUT RUNNING A COMPANY?"

Armando Zagalo de Lima of Xerox appreciates the French taste for innovative management as much as he enjoys their taste for the good life.

(see next page)

TV's New Parallel Universe

Top players are launching online channels to reach young viewers and big spenders

BY TOM LOWRY

STEVE JOBS MAY HAVE signaled to the world that television would never be the same after he announced the video iPod on Oct. 12. But a group toiling in a suburban office west of Knoxville, Tenn., may have a more immediate impact on TV's future. Programmers, engineers, and ad sales folks at Scripps Networks Inc., a unit of E.W. Scripps Co., which owns cable channels Food Network and Home & Garden Television, were busy that day, as they have been for months, prepping for the launch of as many as 10 new channels in the next year or so—on broadband. The first, coming to a high-speed Internet service near you as early as December, is still unnamed, but it will use short, informational video clips and interactivity to bring all manner of advice about kitchen design to people on their computers. "These new channels will allow us to do something we couldn't do on [traditional TV]," says John Lansing, president of Scripps Networks, "which is to dig even deeper into our specific topics."

Suddenly, broadband is opening the floodgates for a new kind of TV show—only not on TV but online. In just the past few months some of the biggest TV names have announced new broadband channels, from MTV Networks to Comedy Central to ABC News. If you thought the 400 cable channels focusing on everything from golf to anime were already cutting niches thin, broadband TV is going a step further.

Besides kitchen design, Scripps preparing to roll out gardening a woodworking channels. Walt Disney has launched Disney Connection, broadband outlet that offers games a video clips of Disney characters to ki Oxygen Networks' Oh! Baby channel fers tips to new parents, including a re lar feature, *Kids Behaving Badly*. M just appointed onetime Web desig Jason Hirschhorn to be its first chief di tal officer, overseeing broadband stra gies. Other TV titans, such as CBS Bro casting Inc. and NBC Universal Inc., b with new media units, are preparing s cialized high-speed offerings as w "We want to be as agnostic as we can delivering shows, sports, and news," s Bob Wright, chairman of NBC Univers "That's why we've been so pleased to how comfortable people are in getti programs in new ways."

NEW BUZZ MACHINE

IT HAS THE MAKINGS OF another Int net gold rush. With improved speeds a video quality online, not to menti broadband's growing reach (estimat conservatively to be in 40 million U homes by yearend), TV executives

Got a Few Minutes?

Taking advantage of higher-quality video and wider availability of faster Internet speeds, Web TV channels are offering short-form fare in hopes of nabbing bigger chunks of advertising gold. In the fray:

MOTHERLOAD

LAUNCH Nov. 1 by Comedy Central (comedycentral.com/Motherload).

PROGRAMS Highlights from *The Daily Show with Jon Stewart*, *South Park*, *The Colbert Report*. At first, about 15% of content will be created just for Motherload.

COOLEST THING Being able to e-mail video clips or playlists of clips from a vast library of comedy bits to your friends.

KITCHEN DESIGN

LAUNCH Tentatively early December, by E.W. Scripps, which owns HGTV and the Food Network.

PROGRAMS Tips and instructional videos on all aspects of designing a new kitchen.

COOLEST THING An interactive feature that will let users design their own kitchens right there on the channel, including placement of cabinetry and appliances and previewing color schemes.

MTVU UBER

LAUNCH Oct. 10 by MTV Networks (mtvU.com/uber).

PROGRAMS A spin-off of MTVU, the college TV network from MTV. The channel offers lots of music and news clips and content by students.

COOLEST THING MTV partnered with Cisco to award 10 $25,000 grants to students to create games, movie shorts, and music videos to be shown on the channel.

ESPN360

LAUNCH January, 2005, by ESPN Networks (available by yearend to 7 million broadband subscribers)

PROGRAMS Video clips from *SportsCenter* to poker tournaments to *Pardon The Interruption*.

COOLEST THING The jukebox-like screen can be reduced to an icon similar to one on a Portable PlayStation that can move arounc a computer screen.

European President Armando Zagalo de Lima says Xerox can rely on the French for innovative business practices.

You're in charge of Xerox across Europe. How does France fit into the picture?

Xerox France has consistently been one of our best performance units. It's been that way for a very long time.

What's the secret behind that success?

Strong leadership. There's always a link between senior leadership and success. Over the past 15 years, at least four of Xerox's heads of Europe have been French. They've instituted some highly innovative management practices and they've been extremely successful with them.

What sort of new thinking has your French unit come up with?

To give you just one example, there's the concept of concessionaires. That's a French word, by the way. It means we have a third-party company selling only Xerox solutions in exclusivity. It's a familiar idea in the car industry, but very original in our business. When our French unit came up with the concept 25 years ago, the rest of the company was extremely skeptical. But the French proved it could work and make money. It's now become a business model for Xerox all over the world.

Xerox in France

- Over 4,000 employees
- Over 140 concessionaires and more than 300 distributors
- Grenoble research facility is one of the four main Xerox innovation centers around the world

How would you sum up the French?

Creative, very open to doing things differently, to going after a big idea and thinking 'out of the box'. France is a place where wild ideas can actually become reality. The French have that capacity to dream up a vision, build a plan to achieve it, then execute it.

What are they like to deal with?

The French have been very responsive to past criticism and are much more willing to conduct business in English. French executives are very open and enjoy working face to face. They like people to come and say: 'If there's a problem, call me and I'll be here'. And they're loyal.

> "France is a place where wild ideas can actually become reality. The French have that capacity to dream up a vision, build a plan to achieve it, then execute it."

A French customer will stay committed to his supplier. I've always had the feeling I could rely on the French.

Everyone knows what Xerox means. What does France stand for?

It's one of the world's great cathedrals of good taste. It's art, it's fashion, it's design, it's food and wine. And it's business too. You go to a lot of countries and you say, "I could do business here, but I'm not sure I want to live here." You don't say that in France. France is a place where you can do business and still appreciate the good things in life.

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THE NEW FRANCE. WHERE THE SMART MONEY GOES.

rushing to connect with younger audiences that are less and less riveted to traditional TV. Getting a foothold on the Internet, especially if it creates buzz, is also a way to recapture ad dollars that have migrated away from the 30-second TV spot. On the Web, ads can be positioned strategically next to programming and measured with greater accuracy. Broadband may also allow executives, bound by the costs and the creative parameters of big-time TV, to take more chances. "This new distribution platform gives content creators a direct relationship with consumers without having to go through a [regional] cable or satellite carrier," says Jeremy Allaire, founder of Internet TV service company Brightcove, which has been hired by Viacom, A&E Television Networks, and Oxygen Networks to help them create new broadband channels.

LOW-COST PILOTS

TV EXECS WILL NEED that kind of freedom as they go up against a slew of upstarts that are creating their own channels. And why not? The barriers to entry are incredibly low vs. TV. Essentially, if you have a $300 video camera and the software to create a site, you're in business. Even sophisticated TV channels are able to launch some broadband outlets for under $10 million. "The best programming is still going to be on TV in the next few years," says Richard Greenfield, an analyst at Fulcrum Global Partners LLC. "But after that, who knows?"

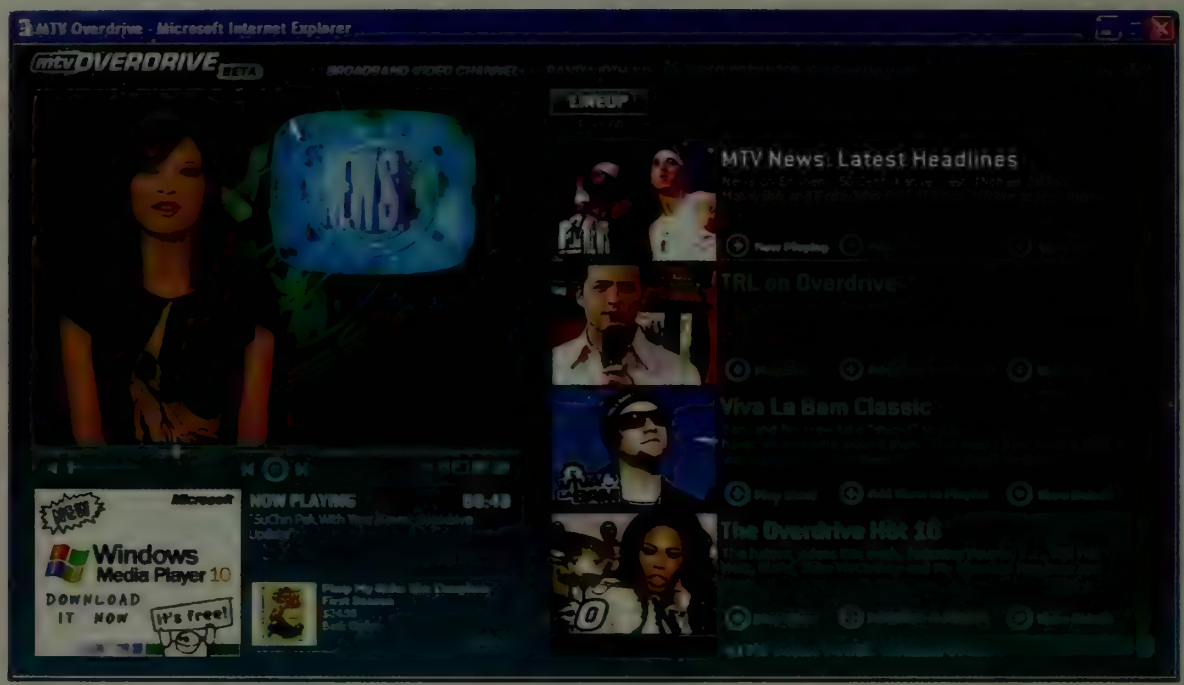
Watching a broadband channel, at least in these early days, is an altogether different experience from kicking back in the living room for a couple of hours. These video-rich offerings are fast-paced, with streamed segments that rarely exceed five minutes. If watching an hour-long episode of *CSI: Crime Scene Investigation* is akin to eating a five-course meal, watching a news snippet from broadband channel MTV Overdrive is a light snack.

So far, much of what's offered are abbreviated or behind-the-scenes versions of existing TV shows, but more and more programming will be made for broadband only. Larry Kramer, president of CBS Digital Media, recently oversaw the revamp of his network's news and sports Web sites, with more broadband-friendly video offerings. He figures networks like his could use broadband as a testing ground for original shows, albeit in shorter form. And if they catch on, such shows could even make the reverse trip back to the network. The result could be, in essence, a new, lower-cost pilot system for TV. "It is all an experiment now," says Kramer. "We are going to have to learn what programming plays best in each format."

Meanwhile, broadband is proving to be liberating for all kinds of TV that's already on the shelves. At Comedy Central, which launched its MotherLoad broadband channel on Nov. 1, users can get their hands on more than 500 free comedy clips to e-mail to friends, including recent bits from new shows such as *The Colbert Report*. Up to 80 new clips will be added weekly, which if e-mailed among friends would b a promotional boon, says Michele Gan less, general manager of Comedy Centr Studies show that over 80% of Come Central viewers have broadband. "W win," says Ganeless, "when they tune in both of our channels."

Broadband's flexibility enables outf like Scripps to approach advertisers in ne ways, too. For years the boast of standa TV was that it would one day offer intera tivity, allowing couch potatoes to cli deeply into ads to ord products. The world still waiting. "The long held promise of iTV here today—with broa band," says Lansin The fact that the U.S. h more than 25,000 ba and kitchen store makes broadband eve more alluring f Scripps since its ne channels can sell class fied ads to all those me chants. And what adve tisers want most is to b next to video. Says Je Meyer, a senior vic president for interactive sales at Scripp "There is more money than the marke place can handle right now for good, hig quality streaming video." One recent dea Microsoft Windows XP recently signed o to be sole sponsor of a 13-part, broadband only cooking series with Food Network' Dave Lieberman.

After hearing terminal prognose about television's future in the Interne Age for years, caretakers of the mediu that started some 65 years ago are sud denly, if cautiously, starting to revel in a the possibilities. There's plenty still to b worked out, including rights issues fo made-for-TV program ming used elsewhere. An not everyone is ready t declare the sit-and-watc experience of regular T dead just yet. What will b most important, as it ha always been, says CBS' Kramer, is creating "grea content." Without it yo won't get an audience— not for an hour, not eve for five minutes. ■



MAJOR PUSH MTV has hired its first chief digital officer to lead broadband strategy

Demand from advertisers is fueling the online programming explosion

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Thirty

Broke

The **real** price of a college education today

BY SUSAN BERFIELD

PAIGE NICHOLS HAS A CERTAIN STOICISM ABOUT HER, WHICH HAS HELPED HER OVERCOME disappointments big and small. She was born in Oklahoma City in 1975, a time of plenty for her family. Her father was prospering as a commodities trader, and he liked to spend his money. Paige would turn out to be the same way. But by the time she entered college in 1993, their financial situation had become, she says, considerably more "volatile." Her parents had been able to pay for the education of her two sisters, 11 and 13 years older than she, but told Paige they couldn't do the same for her.

She finished up at the University of Tulsa in 1997 with a business degree and $20,000 in student loans, which makes her, by official reckoning anyway, a typical graduate. She is now paying off her loans, $300 a month; at that rate it will take her until she's about 50. "Twenty thousand isn't even that much, but it feels hefty," she says. "I'm not making any headway."

Like many who emerged from adolescence amid the promise of the late 1990s, Paige never imagined that money would be the issue upon which crucial decisions in her life would turn. But it is. She has been fascinated with forensic psychology ever since reading a book in college about a woman who studied serial killers, and she was accepted into a master's degree program at the Chicago School of Professional Psychology in 2004. Before long she reconsidered. "I dream big," she says, "then reality seeps in." Paige would have had to borrow at least $32,000, which seemed like "way too much to think about," especially since afterward she might earn less than she would in the corporate world. "I could not justify putting myself in that financial jeopardy," she says. "But it could have been my life's passion."

CREDIT CARDS

In 2004 **average credit-card debt** among 25-to-34-year-olds was

$5,200

Data: CardWeb.com

Paige belongs to the first generation that came of age with the Internet, grew up marketed to at every turn, is too young to remember the Vietnam War, Watergate, or the Beatles: There are all kinds of ways to describe today's 30-year-olds. But what may really come to distinguish them is that they could be the most indebted generation in modern history.

Two new economic realities are at work. Many had to borrow serious money to attend colleges that are ever more costly. And as soon as they entered school, they were offered credit cards; by 30 many have accumulated thousands of dollars of that very expensive debt, too. Imprudent choices sometimes have compounded their troubles. The consequences can be

PHOTOGRAPHY BY JOE CALVIELLO/BW; PHOTO ILLUSTRATION BY DAVID RUDES/BW

CURRENT DEBT: $24,000

Paige Nichols

Student loan debt of "twenty thousand isn't even that much, but it feels hefty"

BORN Feb. 11, 1975, in Oklahoma City

EDUCATION Attended the University of Colorado in Boulder and Oklahoma State in Stillwater. Then received a BA in business with finance major from University of Tulsa in December, 1997.

POSITION Product manager for marketing at ShopLocal in Chicago

SALARY $65,000

STUDENT LOAN DEBT $20,000

MONTHLY PAYMENTS $300 for the next 20 years

CREDIT-CARD DEBT $4,000

MONTHLY PAYMENTS $300

profound: Many of those 30-year-olds feeling unduly burdened by their financial obligations have had to make compromises on some of life's vital decisions.

Paige is a typical graduate not only because of the amount of her student loan debt but also because of the way in which her attitude toward it has shifted. In those early years, she felt unprepared for life on her own and had what she calls an immature attitude toward money. She paid as little as she could on her student loans, about $50 a month, while working in Tulsa as an accountant at Deloitte & Touche and later at WilTel Communications Group Inc. as a product manager. She could have handled making higher payments, but that would have meant scrimping. Paige, though, had long ago learned the prevailing cultural language of brand names and status symbols. Living in reduced circumstances simply didn't correspond with what she thought she understood about being an adult. "My lifestyle was a little out of whack," she says. "I expected to be able to live th way my parents raised me."

Now, after two turbulent years in Chicago, Paige is happi employed as a product manager for a Web site called ShopLoc LLC, earning $65,000 a year. She's hoping to buy a place of h own before she's 35 years old, maybe invest in real estate with group of friends, start saving more money for retirement. "W were supposed to be the slacker generation," she says, "but think we grew out of it."

Dreams Put On Hold

The consequences of student-loan debt on graduates in 1987 and 2002

	1987	2002
CHANGED CAREER PLANS	11%	17%
DELAYED BUYING A HOME	23	38
DELAYED GETTING MARRIED	9	14
DELAYED HAVING CHILDREN	12	21

Data: Nellie Mae, 2003 (College on Credit: How Borrowers Perceive their Education Debt)

No Guarantees

IN MYRIAD WAYS, the economics of being 30 have change for the worse. A college degree is now the minimum require to find a place in the working world that affords some job sa isfaction and material comfort. But it doesn't offer protectio against turmoil in the labor market, as it once did. Nor does guarantee such things as health insurance or a retiremen plan. And real earnings for college graduates without an ad vanced degree have fallen four years in a row, for the first tim since the 1970s.

The cost of higher education, however, has increased so dra matically in the past decade and a half—up by 63% at publi schools and 47% at private—that more students have to borro tens of thousands of dollars to attend, ensuring that many c them are paying off those loans well into their 40s. The medi an debt-to-income ratio now is about 8%. But fully one-quarte of graduates are paying more than 12% of their income, a leve many financial experts regard as worryingly high. That burde will only grow: Interest rates on student loans are going up fo the first time in five years.

Their financial obligations leave them particularly vulnera ble to life's discontents. Nellie Mae, the student lender, foun that 55% of all borrowers felt hampered by debt in some wa in 2002: They changed career plans, gave up on graduat school, put off buying a home, getting married, or havin

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CURRENT DEBT: $111,000

William R. Love

"There's a real disconnect between what students today think they can have after graduation and reality"

BORN July 25, 1974, in Long Beach, Calif.

EDUCATION Over a decade, attended Marywood University, Penn State at Scranton, and Monroe Community College in Rochester before receiving BS in Management Information Systems at Rochester Institute of Technology in May, 2002; will finish MBA there in November, 2005.

POSITION A temporary, full-time job as financial analyst at Constellation Brands

STUDENT LOAN DEBT $27,000 for undergraduate degree, $44,000 for MBA

MONTHLY PAYMENTS $280 for now

CREDIT-CARD DEBT $40,000

MONTHLY PAYMENTS $700

kids. "This is the first generation who won't necessarily do better than their parents," says Tamara Draut, director of the economic opportunity program at Demos, a research and advocacy organization in New York. "They've been told: 'Apply yourself. You'll get a job, a home.' For many young people that's not the case."

Turning 30 has long had iconic status in American society: It is associated with a seriousness of purpose, a willingness to plan for what still might be an indistinct future. But student loan debt can diminish that sense of stability. Michelle Chin, a scrappy, confident, 31-year-old graphic designer who lives in East Los Angeles, says what bothers her most about her financial situation is that she can't save much money. She graduated from Art Center College of Design in Pasadena, Calif., seven years ago and now has $42,000 in student loans and $7,000 in credit-card debt. As Michelle says, "I'd like to hold on to more of my cash, but that almost feels frivolous."

Thirty years ago, when many of their parents attended school, it was entirely possible to get through college with modest family savings and steady work during the summer. Since the mid-1980s, though, tuition has been growing f faster than many families can afford. The price of public co leges, where about 80% of all students are enrolled, increase 28% in the past five years alone, far more than in any five-ye period since 1975. At private colleges, the total cost increase 17%. Those figures, it should be noted, already take inflatio into account. At the same time, outright grants have bee shrinking as a proportion of total financial aid. "The costs education are moving from the government to families, and families from parents to kids," says Melanie E. Corrigan, a sociate director of national initiatives and analysis at th American Council on Education in Washington.

A Rite of Passage

THESE TRENDS HAVE INTERSECTED before—paying off co lege loans has never been easy, and earlier generations have ha to contend with weak job markets—but they are felt more keen ly today. Almost two thirds of students hav to borrow money t get through school; a many as one-quarte may be accumulatin credit-card debt t help pay for tuitio The median debt fo college graduates i 2004 was $15,162, a increase of 66.5 since 1993. That ma not seem like a crip pling sum, but plent of individuals ow much more. Back i 1993, only 4.2% o

Schooled In Debt

Why this generation is broke

FOUR-YEAR BACHELOR'S DEGREE AT A	GRADUATED WITH DEBT	MEDIAN AMOUNT BORROWED	MONTHLY PAYMENT
PUBLIC COLLEGE 1992-1993	24.8%	$8,226*	$95
PUBLIC COLLEGE 2003-2004	58	14,671	169
PRIVATE COLLEGE 1992-1993	40.4	12,639	145
PRIVATE COLLEGE 2003-2004	69.2	17,125	197

Data: ACE Center for Policy Analysis 2005 (Federal Student Loan Debt 1993-2004)

*All dollar amounts are constant 2003-2004 dollars

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graduates had loans exceeding $25,000. A decade later, 17% did.

Today's 30-year-olds are also the first generation for whom having a credit card was a rite of passage. Most of their parents couldn't get a credit card until well after graduation. But beginning in the early 1990s, students have been bombarded by tempting offers at a time when they were just scraping by. For those whose financial education had scarcely begun, it seemed like free money: Spend a couple of hundred dollars and only pay the minimum balance of $10 a month. So students used their cards to buy computers, clothes, gas, textbooks, and sometimes even to pay for tuition. Living with debt has become perfectly acceptable: Last year 76% of college students had credit cards and their average debt was $2,169. "We wink at the magical thinking that credit-card companies encourage us to engage in," says Darryl Dahlheimer, a program manager at Lutheran Social Service Financial Counseling in Minneapolis. "The bitter 30-year-olds are the ones who are still paying off the pizza they ate when they were 20."

When these students start out in the working world, many use their credit cards to fund a richer lifestyle than they can afford, get by between jobs, or cover emergency expenses. The average credit-card debt among 25-to-34-year-olds was $5,200 in 2004, 98% higher than in 1992. "Young people are taking on a level of debt that was never possible for an earlier generation because it's not based on income," says Robert D. Manning, author of *Credit Card Nation* and professor of finance at Rochester Institute of Technology. "This is a generation that has a razor-thin margin of error."

Few would argue that building up credit-card debt is in anyone's best interest. Most economists, though, believe that borrowing $20,000 or so for a degree that, in the past anyway, would enable graduates to earn $1 million more over their lifetime is a pretty smart investment. But for those who have to borrow considerably more, or come from families that can't slip them a couple of thousand in a pinch, student-loan debt can be a real burden. "We're a society that values freedom of choice, but debt can restrict and narrow choices," says Gaston Caperton, president of the College Board and former governor of West Virginia. The real price of a college education may have to be calculated by different means altogether.

Reality Check

IT TOOK WILLIAM R. LOVE a full decade to get through college, mostly because he kept quitting to make what money he could at places like Burger King and Friendly's Ice Cream. Then, when he finally graduated from Rochester Institute of Technology in 2002, he couldn't find a decent job. His wife, Jessic pressured him to take whatever he could find, and eventually did. But he begrudged her; she was disappointed in him. A ye later their marriage collapsed.

Now, at age 31, he is about to finish his master's degree business at RIT. William is charming and highly capable a has lots of ideas about what he might do. He thought of movi to Chicago, a city he regards as full of promise. But he's reali ing that to secure the $70,000-a-year job he hopes for, he has be willing to go pretty much anywhere. He would, though, li to stay within driving distance of his parents, who live in ru Pennsylvania; money for plane tickets home may be hard come by. William knows he will have to live frugally for years that he can pay off the $71,000 he owes in student loans and t $40,000 balance on his credit cards.

William lives with his girlfriend, Savita Thakur, who is a 2 year-old technical writer and part-time student in the sa MBA program. But he won't be in a position to get marrie have children, or buy a house for a long, long while. "I have meet my financial goals to pursue my career properly. I ca take on more debt and do that," he says. In this, he is not alon Fourteen percent of graduates said in 2002 that they had d layed marriage because of their loan obligations, compar with 9% in 1987.

William met Jessica at Marywood University in Scranton, P where he completed his freshman year and then dropped o

Ed.101

Why it's so much harder to pay for school in 2005 than it was in 1990*

MEDIAN FAMILY INCOME	up 5.8%
TOTAL COST AT PRIVATE FOUR-YEAR COLLEGES	up 47%
TOTAL COST AT PUBLIC FOUR-YEAR COLLEGES	up 63%

*All figures adjusted for inflation

Data: U.S. Census Bureau, College Board (*Trends in College Pricing 2005*)

CURRENT DEBT: $116,000

Cristina García Gamboa and Manuel Gamboa

"We owe more in student loans than on our house. You convince yourself that it's good debt"

BORN Cristina: Oct. 24, 1975, in Pasadena, Tex.; Manuel: May 8, 1975, in Hollywood, Calif.

EDUCATION She has BA in Latin American studies and economics from Smith College, May 1998; MS in integrated marketing communications from Northwestern, December, 2004. He graduated from Massachusetts Institute of Technology with BS in mechanical engineering in May, 1997; expects to graduate with MBA from University of Texas in Austin in May, 2006

JOB She's a manager in SBC leadership development program; he finished an internship with Intel in Rio Rancho, N.M.

SALARY Together they hope to earn about $170,000

STUDENT LOAN DEBT AT GRADUATION: $21,000 from Smith, $63,000 from Northwestern, $27,000 from MIT, $37,000 from UT

MONTHLY PAYMENT: $1,256 for 10 years

CREDIT-CARD DEBT: None

fter she graduated in 1996, they moved to Rochester, so that ıe could take a job as an auditor for a bank there. When they ere feeling pretty comfortable financially, he returned to hool and this time got through his bachelor's degree in mangement information systems in three years. But in Rochester, ng dependent on such companies as Eastman Kodak Co. and erox Corp., there were few technology jobs available back in ıe spring of 2002. By the fall, he was working on the sales floor CompUSA, and at Sears Roebuck & Co., too.

In February, William found a job at Paychex Inc., the payroll rocessing company; it was only temporary, but at least he could ut his education to use. When his two-month contract was exnded, William thought he had a good chance of being hired for permanent position. So in June he enrolled in the MBA proram as a part-time student. Halfway through his second quarr, he was let go from Paychex and couldn't find another job. In ovember, he took a leave of absence from school. "The friction turned to our marriage," he says. "School was cutting into the me I had to look for work."

William parted from his wife a month later with two credit ırds, $27,000 in college loans, and a car that Jessica signed over him. He used his unemployment checks to pay the rent on a udio apartment. He lived off his credit cards, relying on a small ım that his extended family gave him to cover the minimum alance each month. He returned to school and bought a $3,200 omputer system, then a $1,500 digital camera. He lost 40 pounds from the stress of his divorce and bought all new clothes. At the time, this hyperconsumption seemed normal to William, as it would to many others of his age. "Our culture has trained this generation to believe that success is measured by acquisition," says Nathan Dungan, the author of *Prodigal Sons and Material Girls: How Not to be Your Child's ATM.*

In the summer of 2004, William's life began to unravel. The crises that often discourage young adults were made more intense by his financial troubles. An uncle who had been everything William admired died from cancer. He began doing poorly in school and withdrew from two classes. He was approaching the spending limits on his credit cards. "I knew if I didn't catch myself in time, I would be headed to bankruptcy," he says.

Savita, his family, and an adviser at school helped him cope with his personal losses. By January, William had cut back on his spending and become meticulous about paying his bills on time. His grades improved. He began thinking about how he could manage his finances once he entered the working world. "I've learned my lesson," he says. "There's a real disconnect between what students today think they can have after graduation and reality."

"Sense of Betrayal"

THIS IS A GENERATION with an unusual sense of entitlement. They were brought up as consumers, comfortable with prosperity, certain of their eventual success. For those who graduated when they were in their early 20s, America was at its most exuberant. Then came the recession, September 11, a slow economic recovery, growing job insecurity, pressure all around. "A college education doesn't protect you from the vicissitudes of global competition," says Jared Bernstein, director of the living standards program at the Economic Policy Institute in Washington. Real earnings for full-time workers between the ages of 25 and 34 who have only a bachelor's degree have, in fact, dropped by almost 10% since 2000, by 5% in 2004 alone. This exaggerates the burden of their debt. For many 30-year-olds, establishing themselves takes longer and is more complicated than they thought it would be. "It's so much more difficult to achieve the adult milestones today than it was 30 years ago," says Draut of the think tank Demos. "There is some sense of betrayal."

Cristina García Gamboa, who just turned 30, is articulate and energetic, someone who while reading Madeleine Albright's biography will ask a friend to recommend books on European history for background. She was an exceptional

How Do So Many Wind Up 30 and Broke?

The Case for Private Loans: Yes, the rates are higher and the terms less favorable than other education loans. But for many students, they make the difference between being able to go to college or not.

Money 101: Many colleges and universities are providing basic classes to improve financial literacy.

Video View: Tamara Draut, director of the economic opportunity program at think tank Demos, talks about policies that might help young adults get ahead.

BusinessWeek online

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STRAPPED At 31, California graphic designer Chin has debts of $49,000

student and received scholarships that nearly covered her first three years at Smith College. During vacations, her uncle gave her frequent-flier miles so she could return to Houston, where her mother insisted Cristina work at the grocery store he managed. All of her summer internships had to pay: After her junior year, she worked at Lockheed Martin Corp. during the day and Toys 'R' Us at night.

From the beginning, Cristina's mother, Bertha, didn't see the difference between a diploma from Smith and the community college where most of Cristina's high school classmates went. Her philosophy was simple: Don't pay when you don't have to. Bertha, who moved to Texas from Mexico when she was 17, wouldn't use the term return on investment, as Cristina does, but that's how she looks at higher education. So after Cristina graduated in May, 1998, with a double major in Latin American studies and economics, it was a scandal that she returned home $21,000 in debt and unemployed.

Cristina quickly accepted a $42,000-a-year position as a Latin America analyst with Motorola Inc. in Miami, only to be laid off seven months later when the company reduced its investment in the region. She moved back to Houston, worked at a public relations firm with a Hispanic focus, and lived with her parents. Her fiancé, Manuel Gamboa, had graduated from Massachusetts Institute of Technology in 1997 with about $27,000 in student-loan debt and $3,000 in credit-card debt, and he was living with his family in Chicago while working at Navistar International as a design engineer. By May, 2000, they had saved the $25,000 they needed to host a wedding party for 400 guests.

INCOME

Since 2000 **real earnings** for college grads, age 25 to 34, have fallen almost

10%

Data: BusinessWeek

Cristina and Manuel began their married life in Houston, where they could afford to buy a house, instead of Chicago, where they couldn't. Their $51,000 debt weighed on them, though, and they agreed to cut it in half before they borrowed more to buy a place. They got it down to $26,000 in a year. At the end of 2001 they purchased a $112,000 house eight miles outside of Houston with a $4,000 downpayment. It's a modest place, says Cristina, and with their salaries they could have afforded something "more grand," but they didn't even look, she says, because of their student loan debt.

If Cristina's mother had been planning their lives, that's when they would have started a family. Instead, Cristina enrolled in a 15-month master's degree program in marketing at Northwestern University's Medill School of Journalism in 2003 and Manuel entered the MBA program at the University of Texas at Austin (no more private schools for him) the year after. When he finishes May, 2006, they will have accumulated an additional $100,000 debt. They consider graduate degrees a necessity in the busine world, yet paying for them may well constrain them in importa ways in the years to come.

Feeling the Pinch

CRISTINA'S FIRST JOB offer after Medill was to join SBC Co munications' leadership development program at compa headquarters in San Antonio. That's about 80 miles from Aust which made it a less-than-ideal proposition. But Cristina w wary of being unemployed. "It was frightening to owe $50,0 when we first got married. And now we owe more," she sa "We owe more in student loans than on our house. You convin yourself that it's good debt." She started at SBC in mid-Janua

Cristina and Manuel plan on paying $1,256 a month on th loans for a decade, which is manageable if they live in an fordable city and both work. That makes the prospect of havi children anytime soon not too "realistic," as Cristina puts Their debt has put them in a bit of a quandary. They want one them to stay home with the kids for several years. Cristina a Manuel had many ambitions when they decided to go to gra uate school: Among them was to secure positions that provid enough flexibility, financial and otherwise, for their family. B that time seems further off than they hoped.

These days, Cristina is adjusting to life in a small town mi way between San Antonio and Austin, a long commute in a noi car that needs new tires, not being able to help their family much as they would like, her mom calling her office at night a saying: "You're still there. I thought you went back to school f a better job." It's not quite what she saw for herself at this age. thought I would be living it up at 29," she says. ■

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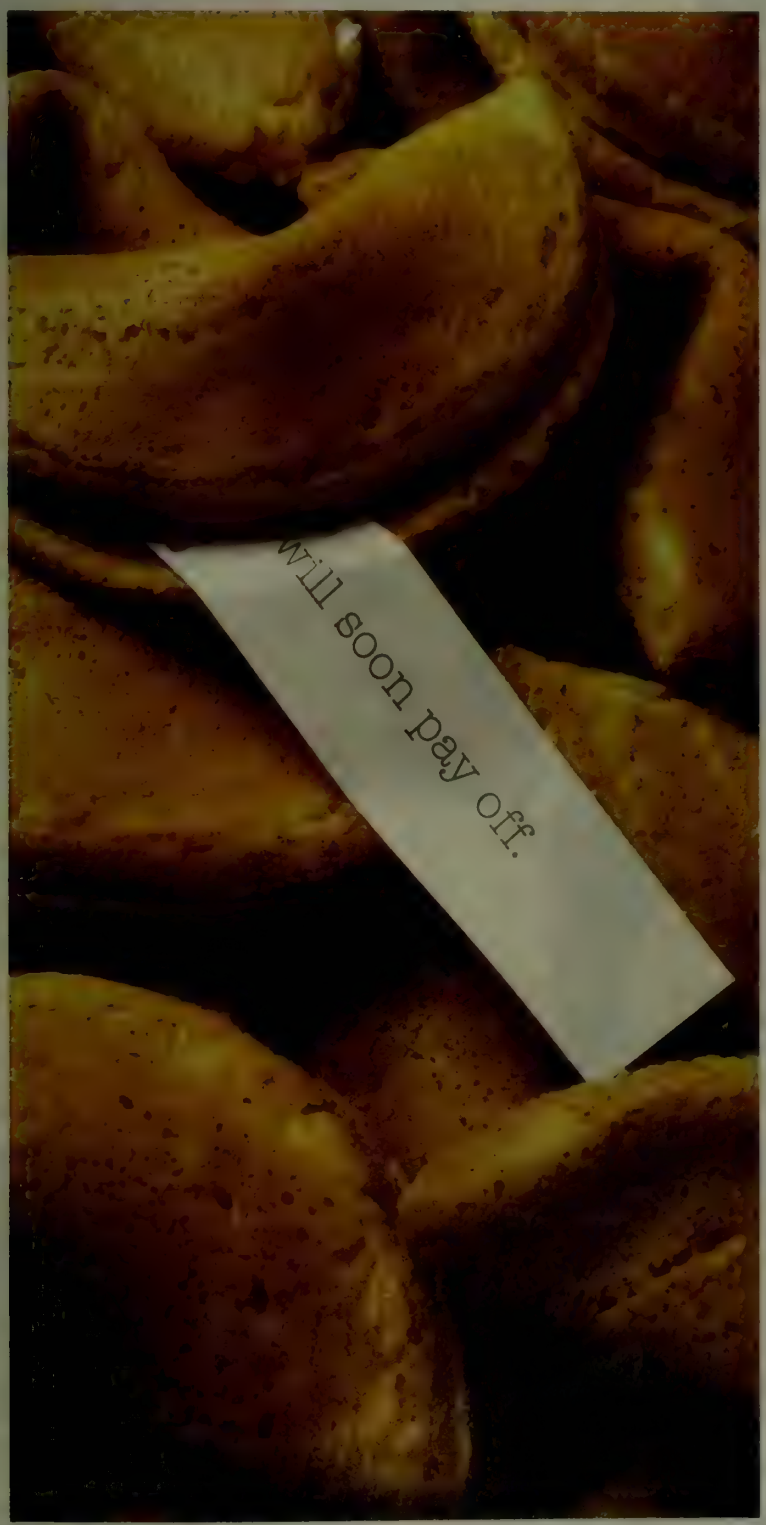

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Debt Collection Puts On a Suit

As consumer loans hit an all-time high, the industry gets more sophisticated

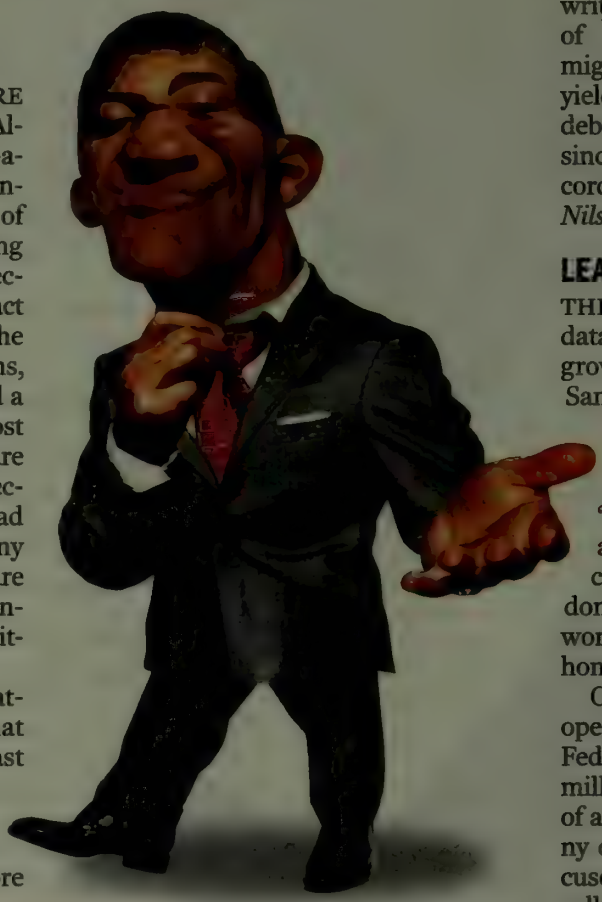
BY CHRISTOPHER PALMERI

DEBT COLLECTORS ARE going corporate. Although the $15 billion-a-year industry still conjures up images of no-neck goons pounding on people's doors, collection agencies are cleaning up their act and tapping Wall Street for money. In the third quarter alone, private-equity firms, venture capitalists, and others invested a record $1.6 billion in the business, almost as much as in all of last year. Six firms are now publicly traded, and two made secondary share offerings this year. Instead of guessing which deadbeats might pony up, firms are using sophisticated software to spot the best bets before buying bundles of bad debts from banks and credit-card companies.

What has captured Wall Street's attention is the mountain of debt that Americans keep piling up. In the past five years, consumer loans have jumped 25%, to a total of $2.1 trillion. The bankruptcy reform that took effect on Oct. 17 promises more business for collection agencies because the new law makes it much harder for many people to dump their debts by going to court. "It won't be as easy to absolve your debts with one stroke of a judge's pen," says James O'Brien, a financial services analyst at Brean Murray & Co.

Those trends are attracting big names into the business. In September, one of Citigroup's venture-capital funds bought a controlling stake in Receivable Management Services Corp., a Bethlehem (Pa.) outfit specializing in business debts; a student lender Sallie Mae bought a company that buys bad home loans. The deal-making is set to continue: There are still 5,215 collection agencies in the U.S. with an average of just 19 collectors each, according to the ACA International, a trade group. "The industry is large, fragmented, profitable, and growing," says Michael Ginsberg, whose boutique investment bank, Kaulkin Ginsberg Co., follows the sector.

The new players are changing how the industry operates. No longer do the top agencies merely collect past-due debt and get a percentage of what's recovered. These days they buy large portfolios written off by lenders, taking on the risk of collection themselves. A portfolio might sell for just 2¢ on the dollar but yield as much as 6¢. The value of all bad-debt purchases has more than doubled since 2000, to $77 billion last year, according to industry trade publication *The Nilson Report*.



LEAVING DODGE CITY

THE INDUSTRY IS USING the latest database technology to handle this fast growth. To avoid less profitable accounts, San Diego's Encore Capital Group Inc. looks at historical data on collections to analyze the debt portfolios before it buys them. If certain people are "making payments on their mortgages and auto loans but not on their credit cards," explains Encore CEO J. Brandon Black, "they are much more creditworthy than a consumer who has had a home foreclosure."

Of course, a chunk of the industry still operates by Dodge City rules. In July the Federal Trade Commission won a $10 million judgment against the principals of a now-defunct Secaucus (N.J.) company called National Check Control. It accused the firm of making repeated phone calls, threatening consumers, and using obscene language. Last year the agency shut down a Rockford (Ill.) outfit, Capital Acquisitions & Management Corp., after receiving more than 2,000 complaints of harassment and deceptive practices.

Although the industry is going corporate, it continues to be plagued by high turnover. Asset Acceptance Capital Corp. in Warren, Mich., the largest of the publicly traded players, narrowly missed its earnings expectations when it reported third-quarter results on Nov. 1. The company blamed the shortfall on its high employee turnover rate—85% a year. Collecting debts may be lucrative—but it's still not a whole lot of fun. ■

Kinder Collectors

The receivables business is cleaning up its act and going corporate by . . .

TAPPING INTO Wall Street capital with share and bond issues, so it can buy big packages of debt

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Data: *BusinessWeek*

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– Raj Bhatia, Merrill Lynch Private Wealth Advisor

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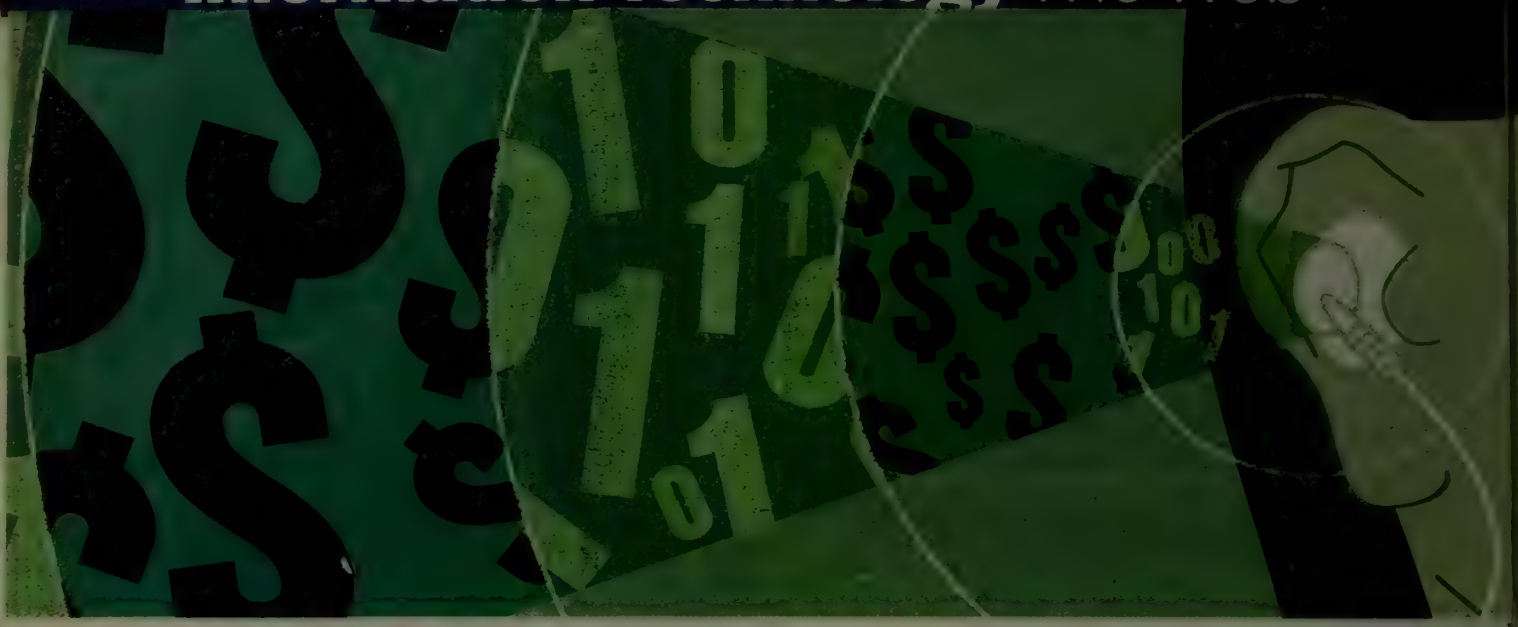

Searching for The Pod of Gold

As podcasting's popularity grows, companies are seeing dollar signs

BY HEATHER GREEN

THE BUZZ THAT BUILT UP around podcasting after its debut a year ago wasn't about money. The technology, which makes it easy for people to create their own audio recordings and post them on the Web, sparked imaginations because it allowed anyone to create a radio show about pretty much anything, from German board games to vegan cooking. Podcasting was innovation for outsiders. And to the early purists, talk of profits was nothing less than heresy.

Not anymore. Today, upstarts, venture capitalists, and media giants are all hard at work trying to figure out how to make podcasting pay. They're experimenting with advertisements, subscriptions, even with having on-air personalities talk up certain products, like in the early days of radio. The latest sign of commercialization? This month, pioneer Adam Curry is launching a podcast network, with 30 to 50 shows that will split ad revenues. The concept won Curry a $9.8 million investment from Kleiner Perkins Caufield & Byers and Sequoia Capital, two top venture firms in Silicon Valley. "We saw the amazing adoption across the Net, and it w obvious that there was a big opportunit says Mark Kvamme, a partner at Sequo

Mavericks such as Curry don't ha podcasting all to themselves anymo Traditional media companies, includi CBS, Clear Channel Communicatio and Walt Disney, are lining up their po casts right next to those from indies. Te giants America Online, Apple Comput and Yahoo! are rushing in with aggreg tion services that collect thousands podcasts in one place, laying the founc tion for selling shows and ads. iTunes fers 15,000 podcasts, and listeners ha signed up for 7 million subscriptions.

Some models are emerging. Ma podcasters are turning to sponsorshi which typically involve a 15- or 30-se ond audio ad at the beginning of t podcast. The popular podcasts usua set flat rates ranging from a few tho sand dollars a month to as much $45,000. In February, Volvo agreed pay $60,000 for a six-month sponso ship of the monthly podcast of Webl Inc.'s Autoblog, as well as advertising the site itself. Over that period, the sho was downloaded 150,000 times.

Because the number of listeners changing fast, a flat-rate sponsorship c end up being a bargain or a bust. KCR

Podcasters' Playbook

Both startups and corporate giants are exploring the technology's potential as a money magnet:

GET SPONSORSHIPS

Most podcasters are mimicking TV's early model by getting sponsors to pay for the content so listeners get shows for free. Monthly prices range from a few thousand dollars to $45,000. GrapeRadio, a weekly indie wine show with 10,000 listeners, gets $3,200 monthly.

PAY FOR LISTENERS

As metrics become more dependable, some podcasters, including CBS and public radio station KCRW, plan to move to the radio model of charging for every thousand listeners. When a current sponsorship ends, KCRW plans to charge $25 per thousand listeners.

SELL SUBSCRIPTIONS

Sports-training podcast EnduranceRadio and wireless service Melodeo are exploring subscriptions and pay-per-play podcasts. TWIT, a tech podcast with over 200,000 listeners, makes $10,000 a month through $2 monthly and $20 yearly donations.

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the public radio station in Santa Monica, cut a deal with Southern California Lexus Dealers for a sponsorship this summer, when the station was getting 20,000 downloads a week. Since then the number spiked to 100,000. When the Lexus deal ends, KCRW plans to charge $25 per thousand listeners. "Once we get out of this sweetheart deal, our goal is to cast our net as wide as possible," says Jacki K. Weber, KCRW's development director.

The rates podcasters are getting are attracting attention. Although there aren't reliable figures for the whole field, the $25 per thousand listeners that KCRW plans to charge seems to be about average for popular podcasts. That's pretty lofty, considering a New York City morning radio show charges between $12 and $15.

Podcasts could soon pinch the radio ad market

Why the premium for some podcasts? They help advertisers reach specific groups, even as media fragments. "You have to think of this more as investing in a valuable customer," says Mary Kang, associate media director at StarLink, a Chicago ad agency. That's one reason Sequoia's Kvamme thinks podcasting could siphon $1 billion to $2 billion away from the $30 billion radio advertising market in three to five years.

Podcasters are experimenting with ways of pulling in money without advertising. *This Week In Tech*, an indie podcast with over 200,000 listeners, asks for $2 donations per month and rakes in around $10,000 a month. Others think listeners will pay a monthly subscription fee for content or perhaps a one-time download charge.

Curry is pushing the limits for indies. His troupe of podcasters plans to offer advertisers a host of possibilities, including spots where a podcaster tries out a product and podcasts devoted entirely to a product or service. Gretchen Vogelzang and Paige Heninger, the Virginia women behind the show *Mommycast* in Curry's network, will promote a new toy from Hasbro Inc., iDog, on each episode.

Still, for all the energy some podcasters are pouring into making money, they will be dwarfed by the thousands who aren't pursuing riches. For them, the original allure of podcasting remains: creating their own show, even if only for a few close friends. ■

MARKETING

And Now, a Podcast From Our Sponsor

Over July 4th weekend, Audrey Reed-Granger, a Whirlpool Corp. marketing exec who lives in Stevensville, Mich., came home to find her husband listening to National Public Radio. A report on podcasting caught her attention, and she asked him to explain it. After he described how podcasts were basically radio shows that people download from the Internet and listen to whenever they want, she had an epiphany. "We should do that," she said. "You and I?" he asked. "No, Whirlpool," she said.

That Tuesday, Reed-Granger marched into her boss's office armed with a proposal. Whirlpool should do podcasts, she argued, but the shows shouldn't push washers, dryers, or any other product. Instead, they should feature interviews with real people—moms balancing work and family, dads staying home to raise kids. "There was a pause," says Reed-Granger, who is director of consumer insight at Whirlpool Brand. "I said: 'Think about who uses our products. It's families.' We're all about helping them in their lives. This is about connecting." She got the green light that afternoon. Reed-Granger now puts out the show twice a week, producing it at home after her toddler goes to bed.

HIS MASTER'S VOICE Purina has a call-in show with vets

Whirlpool is one of a growing number of companies that are turning to podcasting as a way to connect with customers, investors, and employees. As befits a medium only a year old, there's loads of experimentation. Some podcasts are straightforward marketing. Others are more entertainment, with only passing reference to their corporate creators. In June pet food purveyor Purina decided to convert a call-in radio show it sponsors with vets in St. Louis into a podcast. "Our attitude was: It's early days," says Michael Moore, director of interactive marketing for Purina. "It may be successful or it may not be, but let's not wait around and end up being surprised."

There's little downside to such efforts. Any audio clip can be turned into a downloadable podcast with software available on the Web for free. That's one reason companies such as insurer Aflac Inc. can create podcasts of their quarterly earnings calls, even if only a few people listen.

Popularity requires a bit more than reciting gross margins, though. Audiences are gravitating to the kind of things that make compelling radio—good entertainment and useful discussions about family or work issues. One of the hottest: The producer of *Battlestar Galatica*, on the Sci-Fi Channel, hosted a series of 14 podcasts that have been downloaded 1.3 million times. "Issue-oriented marketing will have a lot more success," says Charlene Li, an analyst at Forrester Research Inc. "I don't know if I want to listen on a regular basis to what a company has to say about its products."

Of course, that depends on the product. In September, Simon & Schuster Inc. started producing a weekly half-hour show called *SimonSays*, featuring author interviews and other snippets. And podcasting helps companies feed consumers' appetite for information whenever and wherever they want it. Virgin Atlantic Airways Ltd. is creating travel guides for the 20 different destinations it flies to, from New York to Shanghai. Why? Simple, says Breda Bubear, head of advertising and communications at Virgin Atlantic: "We like to be a pioneer."

—By Heather Green in New York

Attention to

{ ETHICS }

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DERBY FACTORY Trent turbofan jet engines feed the need of the Boeing 787 for lots of electric power

Rolls-Royce, At Your Service

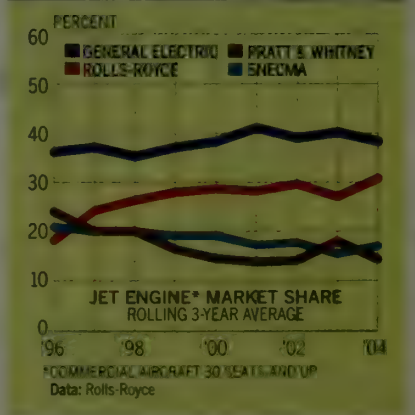
Careful attention to customers is key to its rebound in commercial jet engines

BY STANLEY REED

THE OPERATIONS ROOM at Rolls-Royce PLC's sprawling facility in Derby in the English Midlands houses one of the world's most sophisticated help desks. Using live satellite feeds displayed on video screens, its technicians continuously monitor the health of some 3,000 engines for 45 airline customers. On a recent day the operators noticed that a line charting the "heartbeat" of one of the giant Rolls-Royce turbofans powering an Airbus A340 had veered off sharply from the straight patterns tracking its three fellow engines. "It could be a damaged blade," said Robert J. Hill, head of the Operations Room. "Better get [the engine] off in the next 100 flights."

Hill's center, which went live last year, is a crucial part of Rolls-Royce's drive to win a big share of engine orders for the new generation of Boeing and Airbus aircraft. The airlines don't just want the best engine designs; increasingly, they desire elaborate service networks for decades after the purchase. Hill's people field calls, round up engineers, and solve problems. "In the past, different teams at Rolls-Royce didn't talk to each other enough," he says. "That impaired our services."

ROLLS'S RISE



More careful attention to customers' wishes is paying dividends for Rolls-Royce. Over the past 15 years the London company has clawed its way up from bit player to No. 2 in the market for commercial airliner engines, edging out United Technologies Corp.'s Pratt & Whitney. Rolls, along with General Electric Co., has been selected by the two aircraft makers to supply engines for all three of their major new planes: The Boeing 787, the Airbus A380 superjumbo, and the Airbus A350.

Far from being just a European champion, Rolls-Royce has forged a strong partnership with American Airlines and counts premier Asian carriers such as Singapore Airlines and Cathay Pacific Airways among its customers. Rolls scored a coup last year by winning the first engine order for the Boeing 787 and 50 planes for Japan's All Nippon Airways Co. "They are very aggressive in Asia and are being lifted by higher growth rates in these markets," says Richard Aboulafia, vice-president at Teal Group Corp., a Fairfax (Va.) aerospace consultant.

Rolls-Royce, with its vaunted history as both carmaker and builder of aircraft engines over 101 years, nearly went under in the 1970s before the British government took it over, selling off the auto division. Its emergence as a global player is sweet vindication for the course charted by John Rose, a reticent former banker who became CEO in 1996. Rose, 53, has pushed hard to broaden Rolls's product offerings, not only in civil aviation, which accounts for about 51% of the business, but also in defense, marine engines and energy and power.

ASCENDING STOCK

THERE'S STILL work to do. Rolls-Royce's civil aerospace business is less profitable than GE's larger jet engine division, which chalked up margins of 21% for the first three

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Alger LargeCap Growth Fund (A) 12.31.96 (LARGE-CAP GROWTH FUNDS)	1st (25/678)	1st (58/577)	1st (100/453)	2nd (282/717)
Alger MidCap Growth Fund (A) 12.31.96 (MID-CAP GROWTH FUNDS)	1st (83/541)	1st (66/441)	1st (65/320)	2nd (168/577)
Alger SmallCap Growth Fund (A) 01.01.97 (SMALL-CAP GROWTH FUNDS)	1st (4/522)	1st (58/436)	3rd (223/327)	4th (454/546)

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JOHN ROSE The CEO broadened Rolls-Royce's product offerings

quarters of this ye vs. 12% for Ro in the first ha The British com ny suffers from having an engine the popular Boeing 737. Yet by broade ing its offerings, Rolls has more th doubled its sales, to an average of 1,0 engines a year. "If you don't get on t airframe or win a customer, it may years before you have another opport nity," says Rose. At the end of 200 Rolls-Royce had close to 11,000 engin in service, a number Steve East, analyst at Credit Suisse First Bost in London, expects will grow by abo 7% a year.

A growing fleet means a growing ma ket for Rolls-Royce's service and main nance business, where estimated ma gins of 30% far outstrip those original engine sales (monster turb fans, which may list for as much as $1 million apiece, are often sold at big d counts to win orders). In the first half 2005, servicing revenues increased 18%, to $1.75 billion. Sandy Morris, analyst at ABN Amro in London, is for casting a 65% year-on-year increase operating profits in 2005, to $1.19 b lion, on sales of $11.9 billion for t Rolls-Royce Group. Investors, who har mered Rolls-Royce's shares during t aircraft downturn three years ago, ha bid them up by 46% since the beginni of this year.

Rolls-Royce's recent rise has bee built on the Trent family of turbofan e gines, which have gained a leading pos tion across the range of wide-bodied ai craft. The 700 series was developed power Airbus 330s in the early 199 Models for the Boeing 777 and the Ai bus 340 followed. At Derby, workers r cently showed off a nearly complete Trent 900, which was to be fitted on t third flight-test model of the Airbus 38 superjumbo. The Trent 1000, develope for the Boeing 787, is scheduled for i first test-firing in December.

When airlines choose among engines, ıey weigh price, performance, and fuel onsumption. Mike Terrett, Rolls-oyce's commercial aviation chief, says ıe Trent's three-shaft system has roved useful for generating the much reater electric power required by the oeing 787. Jeff Livings, chief engineer t Virgin Atlantic Airways Ltd. in Lon-on, adds that the layout of Rolls-Royce ngines makes them easy to work on.

Livings' point is a critical one: For car-ers, maintenance is becoming an in-reasingly important part of the game. Vith considerable success, Rolls is per-ıading its customers to adopt an rrangement called TotalCare, under hich they pay Rolls a fee for every hour ıe engine is in flight. In return, Rolls as-ımes the risks and costs of downtime nd repairs. "Rolls is incentivized to put xpensive modifications into the engine) improve reliability," says Bob Reding, enior vice-president for technical operations at Fort Worth-based American Airlines, which operates 178 Rolls-powered planes.

Margins in he service usiness re much igher han they re in sales

Not all customers are thrilled. Geoffrey Shim, assistant general manager for engineering at Hong Kong Dragon Airlines Ltd., complains that Rolls-Royce's aintenance costs are well above those f the competition. "In the future, we will efinitely want to evaluate different en-ine options," he says.

For now, though, Rolls-Royce looks to e winning at least its share on the new odels. The company says it has inched 86% of engine orders for the ew Boeing 787, and orders for the Air-us A380 are evenly split with GE. How-ver, there's a risk that Rolls could be loodied as it battles giant GE, particu-rly on the Boeing 787. George David, hief of United Technologies, said at an ıvestor conference in September that &W "couldn't make the business case ork for that engine." Rolls also has yet) clinch any engine orders for the Air-us A350, while GE says it has signed up 17 aircraft. Yet for Rolls, a company that nce looked like road kill, the No. 2 spot not a bad place to be. ■

–With Diane Brady in New York and Bruce Einhorn in Hong Kong

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SAUDI ARABIA
With stores in 33 countries, Ikea appeals to the world's middle class

JESSE JEFFRION BURKARD

IKEA

» HOW THE SWEDISH RETAILER BECAME A GLOBAL CULT BRAND

BY KERRY CAPELL

When Roger Penguino heard Ikea was offering $4,000 in gift certificates to the first person in line at the opening of its new Atlanta store, he had no choice. He threw a tent in the back of his car and sped down to the site. There, the 24-year-old Mac specialist with Apple Computer Inc. pitched camp, hunkered down, and waited. And waited. Seven broiling days later, by the time the store opened on June 29, more than 2,000 Ikea fanatics had joined him. Some were lured by the promise of lesser prizes for the first 100. Others were just there for the carnival atmosphere (somebody even brought a grill). The newly wed Penguino got his certificates and bagged a $799 Karlanda sofa and a $179 Malm bed, among other items. He also achieved celebrity status: "Whenever I go back, employees recognize me and show me the new stuff."

Penguino is a citizen of Ikea World, a state of mind that revolves around contemporary design, low prices, wacky promotions, and an enthusiasm that few institutions in or out of business can muster. Perhaps more than any other company in the world, Ikea has become a curator of people's lifestyles, if not their lives. At a time when consumers face s many choices for everything they buy, Ikea provides a on stop sanctuary for coolness. It is a trusted safe zone th people can enter and immediately be part of a like-minde cost/design/environmentally-sensitive global tribe. There are other would-be curators around—Starbucks and Virgin do a good job—but Ikea does it best.

If the Swedish retailer has its way, you too will live in a BoKlok home and sleep in Leksvik bed under a Brunskär quilt. (Beds are named for Nor wegian cities; bedding after flow ers and plants. One disaster: child's bed called Gutvik, whic sounds like "good f***" in Ge

CALIFORNIA, U.S.A.
Ikea's flat-packs save warehouse space and make for easy hauling

man.) Ikea wants to supply the food in your fridge (it also sells the fridge) and the soap in your shower.

The Ikea concept has plenty of room to run: The retailer accounts for just 5% to 10% of the furniture market in each country in which it operates. More important, says CEO Anders Dahlvig, is that "awareness of our brand is much bigger than the size of our company." That's because Ikea is far more than a furniture merchant. It sells a lifestyle that customers around the world embrace as a signal that they've arrived, that they have good taste and recognize value. "If it wasn't for Ikea," writes British design magazine *Icon*, "most people would have no access to affordable contemporary design." The magazine even voted Ikea founder Ingvar Kamprad the most influential tastemaker in the world today.

As long as consumers from Moscow to Beijing and beyond keep striving to enter the middle class, there will be a need for Ikea. Think about it: What mass-market retailer has had more success globally? Not Wal-Mart Stores Inc., which despite vast strengths has stumbled in Brazil, Germany, and Japan. Not France's Carrefour, which has never made it in the U.S. Ikea has had its slip-ups, too. But right now its 226 stores in Europe, Asia,

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Customers visit Ikea every day

CEO ANDERS DAHLVIG
Ikea isn't just about furniture. It's a lifestyle

Australia, and the U.S. are thriving, hosting 410 million shoppers a year. The emotional response is unparalleled. The promise of store vouchers for the first 50 shoppers drew thousands to an Ikea store in the Saudi Arabian city of Jeddah in September, 2004. In the ensuing melee, two people died and 16 were injured. A February opening in London attracted up to 6,000 before police were called in.

Why the uproar? Ikea is the quintessential global cult brand. Just take those stunts. Before the Atlanta opening, Ikea managers invited locals to apply for the post of Ambassador of Kul (Swedish for fun). The five winners wrote an essay on why they deserved $2,000 in vouchers. There was one catch: They would have to live in the store for three days before the opening, take part in contests, and sleep in the bedding department. "I got about eight hours of sleep total because of all the drilling and banging going on," says winner Jordan Leopold, a manager at Costco Wholesale.

Leopold got his bedroom set. And Ikea got to craft another story about itself—a story picked up in the press that drew even more shoppers. More shoppers, more traffic. More traffic, more sales. More sales, more buzz. A new store in Bolingbrook, Ill., near Chicago is expected to generate some

(OPPOSITE PAGE, TOP) PHOTOGRAPH BY FREDERIC NEEMA/GAMMA; (THIS PAGE, BOTTOM) PHOTOGRAPH BY CAROLYN DJANOGLY

Home furnishings

宜家家居

CHINA
The mainland is a top market for Ikea development

$2.5 million in tax revenues, so the town is paying down debt and doing away with some local levies.

Such buzz has kept Ikea's sales growing at a healthy clip: For the fiscal year ended Aug. 31, revenues rose 15%, to $17.7 billion. And although privately held Ikea guards profit figures as jealously as its recipe for Swedish meatballs, analyst Mattias Karlkjell of Stockholm's ABG Sundal Collier conservatively estimates Ikea's pretax operating profits at $1.7 billion. Ikea maintains these profits even while it cuts prices steadily. "Ikea's operating margins of approximately 10% are among the best in home furnishing," Karlkjell says. They also compare well with margins of 5% at Pier 1 Imports and 7.7% at Target, both competitors of Ikea in the U.S.

To keep growing at that pace, Ikea is accelerating store rollouts. Nineteen new outlets are set to open worldwide in the fiscal year ending Aug. 31, 2006, at a cost of $66 million per store, on average. CEO Dahlvig is keen to boost Ikea's profile in three of its fastest-growing markets: the U.S., Russia (Ikea is already a huge hit in Moscow), and China (now worth $120 million in sales). In the U.S. he figures the field is wide open: "We have 25 stores in a market the size of Europe, where we have more than 160 stores." The goal is 50 U.S. outlets by 2010: Five are opening this year, up from just one in 200

The key to these rollouts is preserve the strong enthusias Ikea evokes, an enthusiasm th has inspired two case studies fro Harvard Business School and en less shopper comment on the N Examples: "Ikea makes me free become what I want to be" (fro Romania). Or this: "Half my hou is from Ikea—and the nearest sto is six hours away" (the U.S.). this: "Every time, it's trendy less money" (Germany).

What enthralls shoppers a scholars alike is the store visit- similar experience the world ov The blue-and-yellow buildings a erage 300,000 square feet in si about equal to five football fiel The sheer number of items 7,000, from kitchen cabinets candlesticks—is a decisive adva tage. "Others offer affordable fur ture," says Bryan Roberts, research manager at Planet Retail consultancy in London. "But there's no one else who offers t whole concept in the big shed."

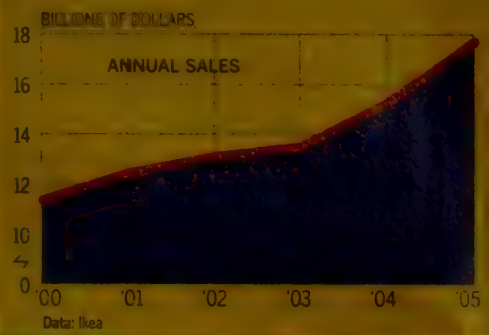
The global middle class that Ikea targets shares buying habi The $120 Billy bookcase, $13 Lack side table, and $190 Ivar st age system are best-sellers worldwide. (U.S. prices are us throughout this story.) Spending per customer is even simil According to Ikea, the figure in Russia is $85 per store visit— actly the same as in affluent Sweden.

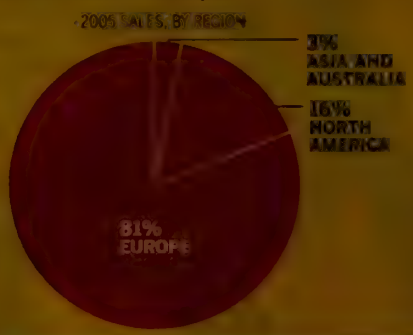
Wherever they are, customers tend to think of the store vi as more of an outing than a chore. That's intentional: As one the Harvard B-school studies states, Ikea practices a form "gentle coercion" to keep you as long as possible. Right at the entrance, for example, you can drop off your kids at the playroom, an amenity that encourages more leisurely shopping.

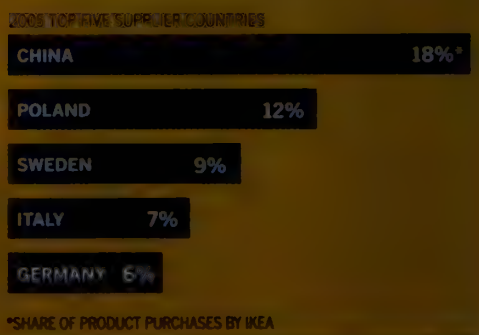
Then, clutching your dog-eared catalog (the print run for the 2006 edition was 160 million—more than the Bible, Ikea claims), you proceed along a marked path through the

IKEA BY THE NUMBERS

With 226 stores in 33 countries, Ikea is now Sweden's best-known export







(THIS PAGE, TOP TO BOTTOM) PHOTOGRAPHS BY HANS-JUERGEN BURKARD/BILDERBERG; CAROLYN DJANOGLY; CHART BY ALBERTO MENA/BW

What a Sweetheart Of a Love Seat

Lars Engman learned the hard way that furniture needs to do more than just look good. After his 6-year-old daughter and her rambunctious pals destroyed his pensive Italian-made sofa in three months the 1970s, the Ikea product developer was spired to create an equally stylish but dproof alternative. "I wanted it to be hard-earing and kid-friendly without mpromising on design," says Engman, w Ikea's design manager, based in mhult, Sweden. It would have to be soft ound the edges yet sturdy enough to thstand years of wear and tear, and have achine-washable slipcovers to make it easy keep clean. More important, it would have meet the Ikea challenge of good looks at a w price. A tall order. But after endless sting of materials and fabrics, Klippan was rn in 1980. More than two decades later, e $249 love seat with its clean lines, bright lors, simple legs, and compact size mains one of Ikea's best-sellers with 1.5 illion sold since 1998.

The saga of the Klippan is that of Ikea in iniature: strong design, logistical efficiency, d constant cost-cutting. Although the sofa as initially manufactured in Sweden, soon after Ikea outsourced production to lower-cost suppliers in Poland. As the Klippan's popularity grew, the company decided it made more sense to work with suppliers in each of Ikea's big markets to avoid having to ship the product all over the world. Today, there are five suppliers for the frames in Europe, plus three in the U.S. and two in China, each of which is guaranteed a minimum volume.

After much experimenting with different materials, the frames are now made from a combination of particleboard, fiberboard, and polyurethane foam, a mix that is cheaper and lighter in weight than solid wood. It wasn't until last year, though, that Ikea finally figured out how to break down the Klippan so it could be flat-packed. Now the frame comes in four separate pieces: The armrests and back slip into slots in the seating base. The new system saves 50% on shipping costs and also frees up room at Ikea's warehouses.

The cotton slipcovers for the Klippan have also gotten cheaper. By centralizing everything from the production of the fabric to the stitching of the covers to just four core suppliers in China and Europe, Ikea has been able to lower the retail price of the covers by 20% since 2004.

Even after a product is designed and in the stores, Ikea never stops seeking ways to lower costs. For instance, it discovered that by using a different type of production process, it could cut down the number of materials used to make the Klippan sofa cushions to just two. All of these efficiencies have allowed Ikea to slash the Klippan's price some 40% since 1999. Currently it sells for around $249 in the U.S., but the price next year will fall to $202—affordable even for a cash-strapped college student, or a harried family with little kids.

IKEA FACT

40%

Drop in Klippan's price since 1999

warren of showrooms. "Because the store is designed as a circle, I can see everything as long as I keep walking in one direction," says Krystyna Gavora, an architect who frequents Ikea in Schaumburg, Ill. Wide aisles let you inspect merchandise without holding up traffic. The furniture itself is arranged in lly accessorized displays, down to the picture frames on the ghtstand, to inspire customers and get them to spend more. he settings are so lifelike that one writer is staging a play Ikea in Renton, Wash.

Along the way, one touch after another seduces the hopper, from the paper measuring tapes and pencils strategically placed bins with items like pink plastic atering cans, scented candles, and picture frames. hese are things you never knew you needed but at less an $2 each you load up on them anyway. You set out buy a $40 coffee table but end up dropping $500 on erything from storage units to glassware. "They have is way of making you believe nothing is expensive," ys Bertille Faroult, a shopper at Ikea on the outskirts Paris. The bins and shelves constantly hold surprises: Ikea replaces a third of its product line every year.

IKEA FACT

32 MILLION

Number of Billy bookcases sold since 1978

Then there's the stop at the restaurant, usually placed at the center of the store, to provide shoppers a breather and encourage them to keep going. You proceed to the warehouse, where the full genius of founder Kamprad is on display. Nearly all the big items are flat-packed, which not only saves Ikea millions in shipping costs from suppliers but also enables shoppers to haul their own stuff home—another savings. Finally you have the fun (or agony) of assembling at home, equipped with nothing but an Allen wrench and those cryptic instructions.

A vocal minority rails at Ikea for its long lines, crowded parking lots, exasperating assembly experiences, and furniture that's hardly built for the ages (the running joke is that Ikea is Swedish for particle board). But the converts outnumber the critics. And for every fan who shops at Ikea, there seems to be one working at the store itself. The fanaticism stems from founder Kamprad, 79, a figure as important to global retailing as Wal-Mart's Sam Walton. Kamprad started the company in 1943 at the age of 17, selling pens, Christmas cards, and seeds from a shed on his family's farm in southern Sweden. In 1951,

the first catalog appeared (Kamprad penned all the text himself until 1963). His credo of creating "a better life for many" is enshrined in his almost evangelical 1976 tract, *A Furniture Dealer's Testament*. Peppered with folksy tidbits—"divide your life into 10-minute units and sacrifice as few as possible in meaningless activity," "wasting resources is a mortal sin" (that's for sure: employees are the catalog models), or the more revealing "it is our duty to expand"—the pamphlet is given to all employees the day they start.

IKEA FACT

150 MILLION

Meatballs were served in 2004

Kamprad, though officially retired, is still the cheerleader for the practices that define Ikea culture. One is egalitarianism. Ikea regularly stages Antibureaucracy Weeks, during which executives work on the shop floor or tend the registers. "In February," says CEO Dahlvig, "I was unloading trucks and selling beds and mattresses."

Another is a steely competitiveness. You get a sense of that at one of Ikea's main offices, in Helsingborg, Sweden. At the doorway, a massive bulletin board tracks weekly sales growth, names the best-performing country markets, and identifies the best-selling furniture. The other message that comes across loud and clear: Cut prices. At the far end of the Helsingborg foyer is a row of best-sell Klippan sofas, playing mod from 1999 to 20 with their e price tags. In 1999 the Klippan was $354 2006 it will be $202 (page 101).

SPIERS-LOPEZ
Ikea's U.S. chief pays close attention to what shoppers want

The montage vividly illustrates Ikea's lentless cost-cutting. The retailer aims lower prices across its entire offering by average of 2% to 3% each year. It goes de er when it wants to hit rivals in certain s ments. "We look at the competition, t their price, and then slash it in half," s Mark McCaslin, manager of Ikea Long land, in Hicksville, N.Y.

It helps that frugality is as deeply grained in the corporate DNA as the obs sion with design. Managers fly econo even top brass. Steen Kanter, who left Ikea in 1994 and n heads his own retail consultancy in Philadelphia, Kanter ternational, recalls that while flying with Kamprad once, boss handed him a coupon for a car rental he had ripped from an in-flight magazine.

This cost obsession fuses with the design culture. "Design beautiful-but-expensive products is easy," says Josephine Rydbe Dumont, president of Ikea of Sweden. "Designing beautiful pr ucts that are inexpensive and functional is a huge challenge."

No design—no matter how inspired—finds its way into showroom if it cannot be made affordable. To achieve that g the company's 12 full-time designers at Almhult, Sweden, al

PLAYBOOK: BEST-PRACTICE IDEAS

How to Build a Cult Brand

Ikea sells a lifestyle that signifies hip design, thrift, and simplicity. For the aspiring global middle class, buying Ikea is a sign of success. Here's how the Swedes do it:

CREATE THE STORY
The retailer is a master at building buzz, which creates evangelists for its brand, who then spread the story by phone, word of mouth, and even blogs from Shanghai to Chicago. The Ambassador of Kul promotion, for example, gives essay contest winners the chance to camp out in a store before it opens. That excites shoppers and generates huge publicity.

SEDUCE THE SHOPPER
Customer focus is so intense that even senior management must work behind cash registers and in the warehouse for brief stints every year. The stores are laid out to promote fun: Restaurants and play centers encourage shoppers to spend the day. Simple touches from free pencils to paper measuring-tapes, make it easy to shop.

INSPIRE THE STAFF
Employees won't get rich, but they do get to enjoy autonomy, very little hierarchy, and a family-friendly culture. In return they buy into the philosophy of frugality and style that drives the whole company.

SURPRISE ON VALUE
Ikea mandates price cuts every year, but designers also deliver on looks and quality. Every year designers must meet stretch goals, like designing a bedroom set for $130.

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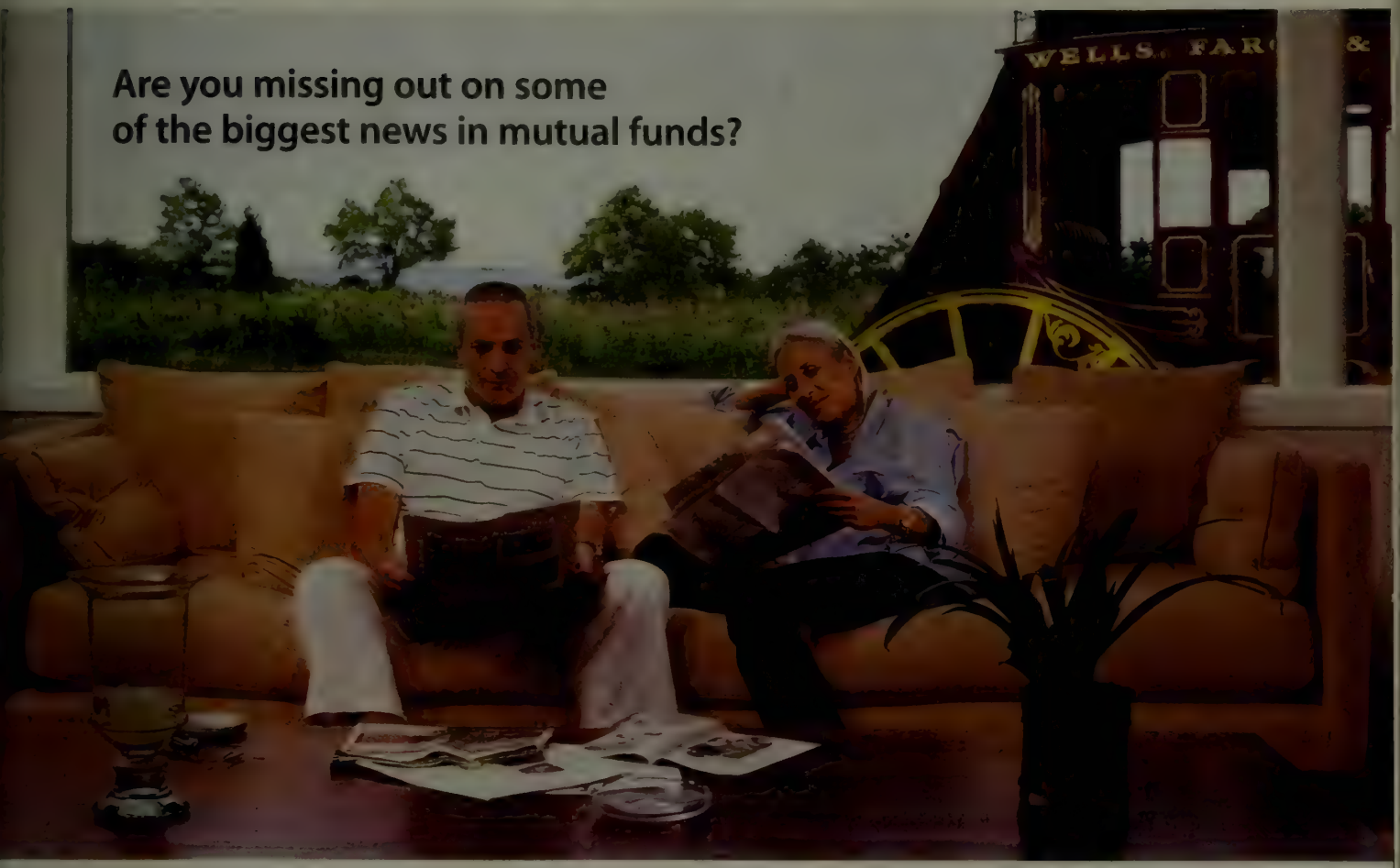

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THE NETHERLANDS
Restaurants at the heart of Ikea stores let customers refuel

with 80 freelancers, work hand in hand with in-house production teams to identify the appropriate materials and least costly suppliers, a trial-and-error process that can take as long as three years. Example: For the PS Ellan, a $39.99 dining chair that can rock back on its hind legs without tipping over, designer Chris Martin worked with production staff for a year and a half to adapt a wood-fiber composite, an inexpensive blend of wood chips and plastic resin used in highway noise barriers, for use in furnishings. Martin also had to design the chair to break down into six pieces, so it could be flat-packed and snapped together without screws.

With a network of 1,300 suppliers in 53 countries, Ikea works overtime to find the right manufacturer for the right product. It once contracted with ski makers—experts in bent wood—to manufacture its Poang armchairs, and it has tapped makers of supermarket carts to turn out durable sofas. Simplicity, a tenet of Swedish design, helps keep costs down. The 50¢ Trofé mug comes only in blue and white, the least expensive pigments. Ikea's conservation drive extends naturally from this cost-cutting. For its new PS line, it challenged 28 designers to find innovative uses for discarded and unusual materials. The results: a table fashioned from reddish-brown birch heartwood (furniture makers prefer the pale exterior wood) and a storage system made from recycled milk cartons.

If sales keep growing at their historical average, by 2010 Ikea will need to source twice as much material as today. "We can't increase by more than 20 stores a year because supply is the bottleneck," says Lennart Dahlgren, country manager for Russia. Since Russia is a source of timber, Ikea aims to turn it into a major supplier of finished products.

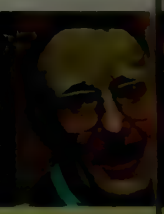
Adding to the challenge, the suppliers and designers have to customize some Ikea products to make them sell better in local markets. In China, the 250,000 plastic placemats Ikea produced to commemorate the year of the rooster sold out in just three weeks. Julie Desrosiers, the bedroom-line manager at Ikea of Sweden, visited people's houses in the U.S. and Europe to peek into their closets, learning that "Americans prefer to store most of their clothes folded, and Italians like to hang." The result was a wardrobe that features deeper drawers for U.S. customers.

The American market poses special challenges for Ikea because of the huge differences inside the U.S. "It's so easy to forget the reality of how people live," says Ikea's U.S. interior design director, Mats Nilsson. In the spring of 2004, Ikea realized it might not be reaching California's Hispanics. So its designers visited the homes of Hispanic staff. They soon realized they had [illegible] up the store's displays all wro[illegible] Large Hispanic families n[illegible] dining tables and sofas that fit more than two people, [illegible] Swedish norm. They prefer bold colors to the more subdu[illegible] Scandinavian palette and display tons of pictures in elabor[illegible] frames. Nilsson warmed up the showrooms' colors, adding m[illegible] seating and throwing in numerous picture frames.

IKEA FACT
16[illegible] MILLION
Ikea Catalogs were printed for 2006

Ikea is particularly concerned about the U.S. since it's key [illegible] expansion—and since Ikea came close to blowing it. "We [illegible] our clocks cleaned in the early 1990s because we really did [illegible] listen to the consumer," says Kanter. Stores weren't [illegible] enough to offer the full Ikea experience, and many were [illegible] poor locations. Prices were too high. Beds were measured [illegible] centimeters, not king, queen, and twin. Sofas weren't de[illegible] enough, curtains were too short, and kitchens didn't fit U[illegible] size appliances. "American customers were buying vases [illegible] drink from because the glasses were too small," recalls Go[illegible] Carstedt, the former head of Ikea North America, who help[illegible] engineer a turnaround. Parts of the product line were ada[illegible]

Sweden's Answer To Sam Walton



To understand what makes Ikea tick, you need to understand the values and vision of its 79-year-old founder, Ingvar Kamprad. It's a vision he'll describe to anyone he meets. "Kamprad has long been a cultural icon and the chief spreader of the Ikea gospel, and he believes it is best spread from mouth to ear," says Harvard Business School Professor Christopher A. Bartlett. "When he speaks, whether it is to customers or employees, people are electrified."

Charismatic, down-to-earth, and a serious tightwad, Kamprad also has an amazing story—dyslexic farm boy becomes retail genius—that most of Ikea's 90,000 employees seem to know by heart.

BusinessWeek online **For the full text of this story and more on Ikea, go to www.businessweek.com/extras**

BoKlok: Putting it all together: Our slide show takes you through the assembly of one of Ikea's prefab houses step by step.

What's in a name? Do you know what a Magicker is? How about a Slutlig? Take our quiz and see if you can match the Ikea product with its name.

Get the story on the Cover Story: For a podcast interview with Correspondent Kerry Capell by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

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Need a Home to Go with that Sofa?

Like many young couples, artist Nina Leth Jensen, 32, and her husband, Jakob, 33, a manager with the Copenhagen metro, feared they would never be able to afford their own home. With a four-year-old child and another on the way, the family was desperate to move to a bigger space but found themselves priced out of the market.

Then in June, 2004, Nina spotted an ad for BoKlok (Swedish for "smart living"), a line of affordable prefab homes marketed by Ikea. "I told my husband, 'this is the house for us,'" says Nina. "We already had a lot of Ikea furniture, so why not have a total Ikea home?"

DENMARK
The Jensens are the new kids on the BoKlok

IKEA FACT

1 DAY
Is the time it takes to assemble an Ikea prefab BoKlok unit

Today, the Jensens live in a BoKlok development in Hillerod, Denmark, just outside of Copenhagen. For $45,000, some 25% less than comparable homes in the area, the family got an airy 800-square-foot, three-bedroom apartment with an open-plan living area, small garden, and garage. Ikea also threw in $500 in gift certificates and the free services of an Ikea designer.

Aimed largely at first-time buyers, BoKlok is proving a big hit, with more than 2,500 units sold in Sweden, Finland, Norway, and Denmark since the program was launched in 1997. In a new development outside Oslo, the 60 homes sold out in 45 minutes. Next up: Southampton, England, where the first BoKloks will go on sale in January. BoKlok, a stand-alone company that is jointly controlled by Ikea and Swedish developer Skanska, also is eyeing France, Poland, the Netherlands, and the U.S. "There is a global need for affordable housing," says BoKlok managing director Anders Larsson. "We want to fill that gap."

To come up with the rig price tag, Ikea enlisted wel known Swedish economis Pia Nilsson. In-store customer surveys then reveal what the market wanted: a safe, low-rise apartment i small-scale development with outside space, open-plan living, and lots of ligh

A BoKlok development consists of several timber-framed buildings, each cor taining five to six apartme Putting the units together i snap. Most of the work tak place on the factory floor. assembly line starts with c penters, who erect the wal and windows. Then a fully equipped Ikea kitchen and bathroom are added. Floo shelving units, and electric wiring are installed before painters add the nal touches. The modular units are then de ered to the construction site on 18-wheel trucks. A crane drops them in place, and builders complete the last fittings, a proces that typically takes just one day.

CEO Anders Dahlvig acknowledges BoK "generates a lot of buzz for the brand," but adds, "we are not a house builder ourselve so we have to be cautious." Yet with more a more people clamoring for the total Ikea lifestyle, Ikea may have to change its tune.

ed (no more metric measurements), new and bigger store locations chosen, prices slashed, and service improved. Now U.S. managers are paying close attention to the tiniest details. "Americans want more comfortable sofas, higher-quality textiles, bigger glasses, more spacious entertainment units," says Pernille Spiers-Lopez, head of Ikea North America.

Can the cult keep thriving? Ikea has stumbled badly before. A foray into Japan 30 years ago was a disaster (the Japanese wanted high quality and great materials, not low price and particle board). The company is just now gearing up for a return to Japan next year. Ikea is also seeing more competition than ever. In the U.S., Target Corp. has recruited top designer Thomas O'Brien to develop a range of low-priced furnishings, which were launched in October. Kmart has been collaborating with Martha Stewart on its own furniture line. An Ikea-like chain called Fly is popular in France. In Japan Nitori Co. has a lock on low-cost furniture.

Perhaps the bigger issue is what happens inside Ikea. "The great challenge of any organization as it becomes larger and more diverse is how to keep the core founding values alive," says Harvard Business School Professor Christopher A. Bartlett, author of a 1996 case study. Ikea is still run by managers who were trained and groomed by Kamprad himself—and who are p sonally devoted to the founder. As the direct links with Kampr disappear, the culture may start to fade.

For now, the founder's legacy is alive and well. The Klipp couches are selling briskly. New lines of foods, travel gear, a toiletries are due soon. Ikea is gearing up for its Christmas t promotion—you buy a live tree, then return it for a rebate (a end up shopping at Ikea in the slow month of January).

And the fans keep clamoring for more. At least once a year, Segrest, a 36-year-old freelance Web designer, and her husba travel 10 hours round-trip from their home in Middletown, Ol to Ikea in Schaumburg, Ill., near Chicago. "Every piece of fur ture in my living room is Ikea—except for an end table, whic hate. And next time I go to Ikea I'll replace it," says Segrest. lure the retailer to Ohio, Segrest has even started a blog cal OH! IKEA. The banner on the home page reads "Ikea in Ohi Because man cannot live on Target alone." ■

–With Ariane Sains in Stockholm, Cristina Lindb in New York, Ann Therese Palmer in Chic Jason Bush in Moscow, Dexter Roberts in Beiji and Kenji Hall in To

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Prefab Meets Style

Architects are rethinking budget boxes —and finding lots of buyers

BY REENA JANA

IS "AFFORDABLE, stylish house" an oxymoron? It may seem so in a still-overheated real estate market. The median price of an existing American home in September was $212,000—up 13.4% from the same period last year, according to the latest figures released by the National Association of Realtors.

HOUSING WATCH

But a new generation of sleek prefabricated housing suggests a cost-efficient alternative. This fall, *Dwell*, the trendy San Francisco shelter magazine, launched a new line of prefab houses called Dwell Homes that targets its design- yet budget-conscious readership. "Cost is a big factor in why prefab is timely," says Allison Arieff, *Dwell*'s editor-in-chief and author of the book *Prefab*. "In my own experience hunting for a house in the San Francisco Bay area, I've been shown shacks for $650 per square foot." In contrast, Dwell Homes average $175 to $250 per square foot—about $530,000 for a two-level, 2,500-square-foot abode.

The seed for Dwell Homes was planted two years ago when the magazine invited an international group of innovative architects to design streamlined homes that could be constructed from low-cost, prefabricated materials. In 2004, *Dwell* built the winning design in Pittsboro, N.C., an airy house with bold lines from New York firm Resolution: 4 Architecture, headed by partners Joseph Tanney and Robert Luntz.

"When 2,500 visitors showed up to the viewing—far more than we had expected—we realized there is a viable interest on a larger scale," says Arieff, who adds that she has received nearly 10,000 e-mails asking her advice on how to purchase a prefab modernist house.

Fascination with prefab has also been brewing in Europe. A partnership between Ikea (page 106) and Skanska produced the first BoKlok prefab home in Sweden in 1997. More than 2,000 units have sold to date. In a study released in September by Britain's Standard Life Bank Ltd., 29% of those surveyed would consider a prefab home. The bank estimates the size of the British market at $2.8 billion, with an annual growth rate of 30%.

$32,900
1,150 sq.-ft. LV Home by Rocio Romero

$541,875
2,550 sq.-ft. house by Resolution: 4 Architecture for Dwell Homes

Buyers of Dwell Homes have three floor plans to choose from, designed by Resolution: 4 Architecture; Lazor Office in Minneapolis; and Empyrean International (formerly Deck House) in Acton, Mass. The latter is also the manufacturer and licensing partner of all the designs. Each option echoes the clean geometry of classic buildings by Frank Lloyd Wright and Buckminster Fuller, both early proponents of prefab housing.

Resolution: 4 Architecture's offering is a version of the design that won *Dwell*'s 2003 competition. The L-shaped plan includes a large first-floor living/dining space encased in glass and an upper-level roof deck with an exterior fireplace.

OPENNESS AND PRIVACY

LAZOR OFFICE'S DESIGN grew out of architect Charlie Lazor's own quest to find an inexpensive modern home for his family. A variety of materials, from steel to bamboo to sandblasted glass, lend textural complexity to an otherwise simple rectangular structure. The house's name, FlatPak, and modular style have much in common with the assemble-it-yourself furniture designed by hip home furnisher

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$536,775
2,526 sq.-ft. NextHouse by Empyrean International for Dwell Homes

$588,200
2,768 sq.-ft. FlatPak house by Lazor Office for Dwell Homes

ings label Blu Dot Design & Manufacturing Inc., which Lazor co-founded.

Empyrean's home, dubbed NextHouse and designed by architect Joel Turkel, features an interior courtyard-like space of wall and glass that extends through both levels of the house, so the second floor can be seen from the first. Despite the openness of the plan, private spaces are tucked into opposite sides of the central living room. The master bedroom has a deck.

Buyers must already own land for the installation, so prices for the homes don't reflect the cost of property or local labor, which can vary wildly from market to market. Empyrean, which has a 57-year history of manufacturing homes, assigns a project manager to serve as liaison between the buyer and the architect as well as the local construction team.

Clearly, even the most chic modernist prefab homes are basically cookie-cutter designs. But *Dwell*'s Arieff likens purchasing one to buying a hip car, such as a Mini Cooper, that is mass-produced yet customizable to a degree. The smallest Dwell home in production measures 1,000 square feet, the largest 4,000. Customers can add or subtract a porch, deck, or garage, among other details.

While figures from the Manufactured Housing Institute show that sales of manufactured homes in general (defined as factory-produced single-family houses) are down—representing 9.8% of single-family housing starts in the U.S. in 2004, compared with 14.8% in 2002—the market for modernist prefabs seems to be experiencing brisk sales. Michael Harris, president of Empyrean, says the company projected sales of 60 units in the first yea Fifteen have been sold in the first month

Dwell and Empyrean aren't alone. Ro cio Romero, an architect in Perryville Mo., has been designing modern prefa houses since 2002. She sells two cube shaped, loft-like homes: $32,900 fo 1,150 square feet and $40,050 for 2,80 square feet. Without any direct tie to larger brand—and even before *The Ne Yorker* profiled her in early October- Romero sold 10 prefab homes in 200 the first year they were available. So fa this year, she has sold 15 and expec 2005 sales to be double last year's.

$95,000
756 sq.-ft. weeHouse by Alchemy Architects

DETAILS, DETAILS

GEOFFREY WARNER OF Alchemy Arch tects in St. Paul, Minn., didn't set out sell prefab homes. But his weeHouse pr totype, intended as a $50,000 cabin for single client, met with surprising d mand. Warner thought he could supp requests in the most cost- and time-effe tive way by coming up with a prefabrica ed model. "We've been seriously offerin the prefab version for about a year an have about 10 houses in the productio process," he says.

The trend toward modernist prefab d fies popular preconceptions that man factured housing is of poor quality an lacks style. But as *Dwell*'s Arieff poin out, factory-controlled, mass-produce components can allow for "a lower ma gin of error compared to wooden bean hammered by hand." In addition, desig conscious details—such as the ste sandblasted glass, and bamboo in Laz Office's FlatPak design—can be includ within a relatively modest budget if t overall costs of a house's structural el ments, such as pre-engineered, mas produced framing, are kept down.

The U.S. market is still young, but wi demand outpacing expectations for st ish prefab homes, more choice—a more buyers—are sure to follow. ■

–With Aleta Davies in New Yo

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From Faux To Fortune

Shoppers clamored for Ora Ito's imaginary goods. Now the real stuff is in high demand

BY RACHEL TIPLADY

ENTERING TOYOTA'S REdesigned flagship store on Paris' Champs Elysées is like boarding a 1960s comic book spacecraft. At the Oct. 27 unveiling of the $5 million showroom, models in white knee-high boots and short gray dresses draped themselves over concept cars, while a deejay played space-age electropop. The 10,000-square-foot space features curved walls of seamless white Corian polymer and a second level that overlooks the ground floor like a *Star Trek* control deck. The clean lines and airy glass are just what Toyota Motor Corp. wanted in order to communicate the company's emphasis on "green" themes. Perhaps most remarkable, Toyota's premier brand-building venue in Europe was designed by a 28-year-old French design school dropout.

The Parisian showplace is only the latest venture for Ora Ito, the new It-boy of European corporate design. In a career spanning just four years he has created ad campaigns, products, and interiors for dozens of companies, including Adidas-Salomon, Davidoff, and Swatch Group. Ito dubs his style "simplexity," meaning a mix of simple shapes that are nevertheless complex to design. Thanks to rapturous response, Ito's Paris atelier now employs 12 people and is on track to pull in revenues of $3 million this year.

BESIEGED WITH CALLS

COMPANIES LIKE TOYOTA choose Ito because he helps their bottom line. At just 24, he created a slim molded aluminum bottle for Heineken that transformed the venerable brewer's beer from dowdy to nightclub chic. Within months of the bottle's launch, Heineken doubled the number of French outlets that carried its aluminum bottles, to 2,000. "We had places like [upscale Paris department store] Bon Marché besieging us with calls. It was unprecedented," says Pascal Gilet, global marketing manager for Heineken, who gave Ito his first contract. The product has since been launched worldwide. Similarly, Ito's 2003 redesign of Paris nightclub Le Cab helped double admissions in one year. Fun-seekers have flocked to see the club's colorful dance floor, mirrored halls, and leather-lined hexagonal alcoves.

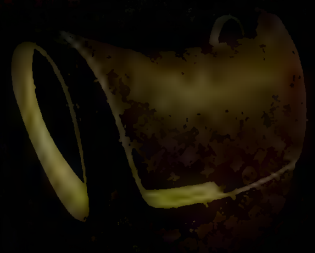
The young Frenchman's path to fame and fortune was ingenious, if reckless. At 21, Ito, whose real name is Ito Morabito, decided he couldn't bear spending 10 years inching his way up the career ladder. So the son of well-known Paris fashion designer Pascal Morabito invented the pseudonym Ora Ito to carve out his own identity. Without using his father's money or connections, he set out to excite the design world with an audacious media stunt. He helped pen two articles for the fashionable French magazines *Crash* and *Jalouse*, presenting a selection of 3D images of completely made-up products for mega-brands such as Louis Vuitton, Apple Computer and Levi Strauss & Co.

The response was electric. Within

Winning Lineup

FAUX VUITTON BACKPACK, 1999

After this fictitious design appeared in French magazine *Jalouse*, Louis Vuitton fans swarmed stores, attempting to actually buy the bag



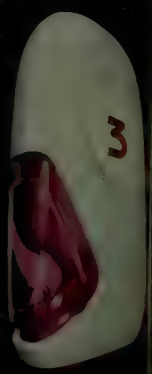
HEINEKEN ALUMINUM BOTTLE, 2002

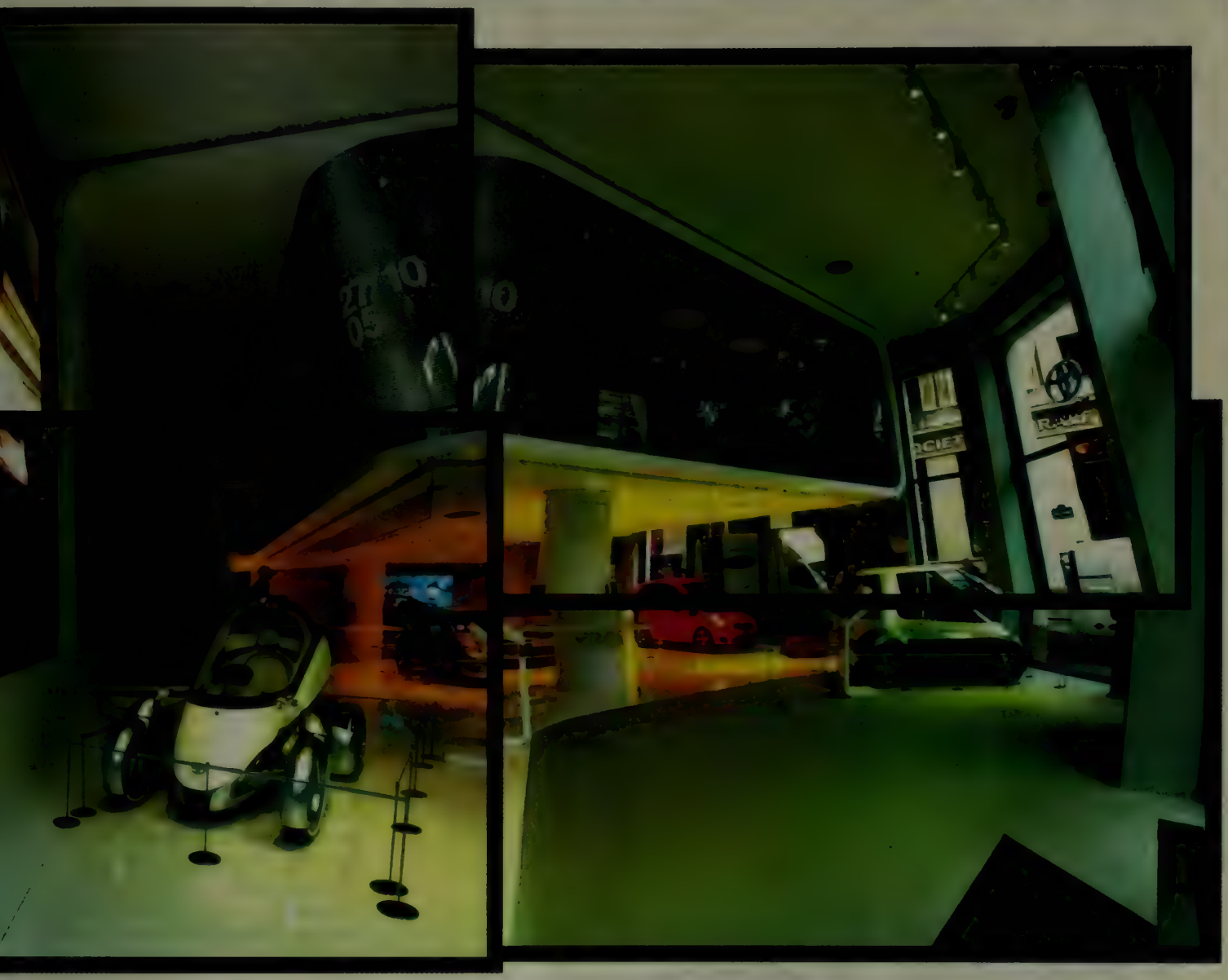
Ora Ito's first real project. The award-winning bottle brought an upmarket edge to the Dutch brewer's business

ADIDAS PERFUME BOTTLE, 2003

This sporty package design, along with a men's version, won five packaging innovation and product design awards

Data: BusinessWeek





SPACE-AGE CHIC Ito's new showroom for Toyota, in Paris, is meant to reinforce "green" themes

eeks of the first article's publication, o's Web site was getting 200,000 visirs a day. A Swiss collector and a host of her watch fans wanted to buy the degner's four imaginary Swatch designs, hose digital red dials and cool curves lded a futuristic edge to the company's assic look, even though no such prodcts existed. Customers inundated luxu- goods company LVMH Moët Henessy/Louis Vuitton with lls and store visits in a esperate attempt to buy o's proposed monoammed backpack. A facry in China bestowed the timate accolade. It lifted e designs and started urning out counterfeits. t was wild," recalls Ito, oting that no companies itiated legal action gainst him because the esigns were virtual and ell-received by consumers and the brands involved.

Impressed with Ito's talent and the reaction to his unsolicited design schemes, companies soon started begging him to work for them. Along with Heineken came Italian furniture-design agency Cappelli and sporting-goods giant Adidas, for whom he created a best-selling perfume bottle. "His talent is in being both a visionary and respecting the equity of the brand," says Eva Ziegler, brand manager for Toyota in Europe, who chose Ito over two Japanese designers for the showroom project (despite his Japanese-sounding name, Ito is of French ancestry).

ITO His watchword: "Simplexity"

These days, Ito can take his pick of clients. His eclectic mix of current projects includes a new lamp for Italian lighting company Artemide, a global refit of automatic photo booths for Britain's Photo-Me International PLC, and a top-secret product for London interior design emporium Habitat. For the moment, Ito plans to continue working for corporations. "Where else can you get the budgets to do exactly what you want?" he asks. ■

BusinessWeek online To see a slideshow of Ora Ito's designs, go to www.businessweek.com/extras

Hidden Value Let Loose

Chipmaker Freescale, spun from Motorola, is a prime example of the power of spin-offs

BY MARK MORRISON

WHEN MOTOROLA Inc. moved to spin off its $5.7 billion semiconductor business in July, 2004, the newly launched company, Freescale Semiconductor Inc., got no respect. Freescale shares made their debut at a limp $13, trading at less than 50% of the valuation accorded larger rival Texas Instruments Inc.

Investors had lots of reasons to be skeptical. Freescale's business under Motorola had piled up hundreds of millions in losses in the early 2000s. Despite a massive restructuring, the unit was operating on razor-thin margins in hypercompetitive chip markets where it seemed to have lost its innovation edge.

But those who didn't pay up for the stock were dead wrong. Just 15 months later, Freescale, which supplies embedded chips and software for wireless handsets, automobiles, and have thousands of other uses, is one hot tech company. Earnings jumped threefold in the latest quarter to $164 million on sales of $1.4 billion. Its stock, at $23, is up more than 70% from its starting point.

How did the smart-money folks so badly underestimate Freescale? Given Motorola's troubled history, investors expected little from the spin-off. They also failed to appreciate the talents of Freescale's new CEO, Michel Mayer. And perhaps most important, they discounted the value that a properly executed spin-off can create. Of the 1[illegible] deals in 2003, 1[illegible] have beat the Standard & Poor's 500 stock index by a wide margin. The spin-off Class of '04 is performing equally well, says Joseph W. Cornell, principal of Chicago research firm Spin-Off Advisors.

The bulk of recent spin-offs are beating the S&P

While disastrous spin-offs such as Delphi Corp. and Visteon Corp. may grab big headlines, many of the deals often result in far stronger businesses. That fact, in tandem with Wall Street's distaste for conglomerates, has a lot of CEOs becoming believers in the magic of spin-offs. American Express Co.'s Kenneth I. Chenault just set loose Ameriprise Financial Inc., its financial advisory business. Henry R. Silverman plans to divide Cendant Corp. into four companies next summer. And Sumner M. Redstone is working on a scheme to split CBS and Viacom Inc. by the end of this year. "Spin-offs usually create huge value because a business goes from being the redheaded stepchild in a large company to a business being run for its own interests," says Cornell.

The decision to send a division off on its own isn't an easy one for most companies, and it wasn't for Motorola. The unit had been part of the company for [illegible] years, and its 22,000 employees were "family," recalls one insider. Then there was the matter of a customer-supplier relationship—Motorola accounts for about 25% of Freescale's revenues. Some execs worried that it would be a mistake to give up an integral part of the parent's innovation pipeline. Yet pressure grew from Wall Street and the board to delink so that Motorola could focus on its core markets.

A team of top managers and directors considered the options, including the outright sale of its subsidiary or a carve-out that would sell just part of Freescale

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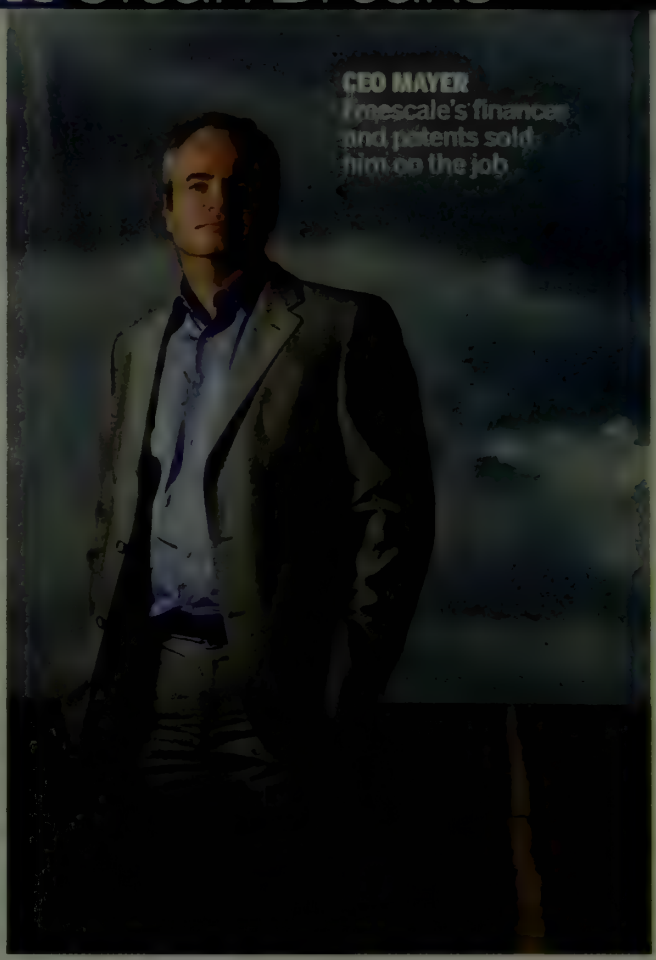
the public. The final decision—probably the most critical to Freescale's ability to prosper—was to make a clean ownership break by distributing all Freescale shares to Motorola stockholders.

That was key, because it meant Motorola was strongly motivated to craft a deal that would make Freescale totally independent and give it the resources to be a muscular player in its markets. Motorola needed Freescale to be strong so it could continue as a strategic supplier of parts for handsets and networking products. "This was about creating value by making Freescale a sustainable, independent company," says Donald F. McLellan, Motorola's vice-president of mergers and acquisitions. As a freestanding company, Freescale should be able to win new customers—especially in the wireless arena, where giants like Nokia Corp. and Samsung Electronics could be reluctant to do business with a supplier owned by a rival.



CEO MAYER
Freescale's finances and patents sold him on the job

ACCOUNTABILITY RISING

MOTOROLA'S NEXT smart move was recruiting a strong CEO in veteran IBM executive Mayer. "My first question was, 'Why were they doing this? Are they dumping a dog or trying to really unlock shareholder value?'" recalls the high-energy Frenchman. Mayer worried about Freescale's sickly earnings: Motorola had put the unit through a massive downsizing in the early 2000s, shuttering 11 of its 23 plants and slashing headcount by 13,000, almost a third. Still, the business had a gross margin of only 29%—and lost $366 million, including writeoffs, in 2003. But after poring over Freescale's debt-light balance sheet, its $750 million in cash, and some 4,900 patent families that Motorola had ceded to it, Mayer took command in May, 2004. He quickly appointed a new executive team including outsiders from IBM and Dell Inc.

To a greater degree than in the past, Mayer held employees, who were each issued stock, accountable for their performance. "It was a little like working for the government in the Motorola days," says one middle-level manager. "It was something extraordinary to get fired. And you could count on getting a 4% raise for strong performance and 2% for a passable rating." Now, he says, top performers get considerably bigger increases and there's no raise at all for many average performers.

Workers' new sense of accountability has helped break down many of the silos that slowed decision-making and discouraged teamwork at Motorola. The idea is to give an engineering culture more customer focus. When working for a unit of Motorola, the man agers at each fabricatio plant tended to focus onl on making their ow monthly productio goals. Now there's mor flexibility. When a wireles customer urgently neede a rush order that woul disrupt the Chandle (Ariz.) plant's monthl quota, its local manager decided to alert headquar ters that they planned t make an exception to ac commodate the rush or der. The production targe was revised and the cus tomer got the parts. Maye says that kind of custome focus is critical even a plants are pushed to b more efficient. Smarte manufacturing is a bi reason Freescale has bee able to boost efficiencie and get its gross margin t more than 43% in th third quarter, four pe centage points better tha the year-earlier quarter.

Mayer is now targeting the produ strategy process for radical change. H believes Freescale was losing the jump o developing timely new products becaus of an ultra-cautious approach to makin commitments to next-generation tecl nologies. "In an engineering cultur there's a feeling that you'd rather be slo and right than fast and wrong," he e plains. "But in the markets we serve, yo need to decide faster and accept th you'll be wrong a few times."

A sour note in Freescale's turnaroun is that revenues are flat while competito are seeing modest growth. This is so eve as Motorola, undergoing its own tran formation under a new CEO, gains sha with its Razr phone and other new pro ucts—which means more business f Freescale. Mayer says Freescale is holdin its own in overall market share.

But while it claims to be getting muc better access to Motorola's major con petitors in an effort to drum up order Freescale can't claim any mega-wins. A alysts want to see if Freescale can leverag its strong position in supplying next-ge eration 3G cellular technology to cu tomers other than Motorola. If May can't deliver market share gains a faster growth, Freescale could lose t very independence it cherishes—and pe haps become a takeover target itself. ■

PLAYBOOK: BEST-PRACTICE IDEAS

How to Create a **Winning** Spin-Off **Freescale's success stems from a few key decisions. Here are some of them:**	**MAKE A CLEAN BREAK**	**DON'T DUMP DEBT**	**CUT THE CORPORATE STRINGS**	**BE GENEROUS WITH INCENTIVES**
	No tracking stocks or carve-outs, please. Total independence gives management the flexibility to build the business.	Start your offspring off with a strong balance sheet. A spin-off needs to focus on execution, not on making big interest payments.	Avoid conflicts in the spin-off's business model. If the spin-off is now your supplier, it needs to treat you like every other customer.	Distribute company stock widely so employees will act like owners and accept tougher performance requirements.

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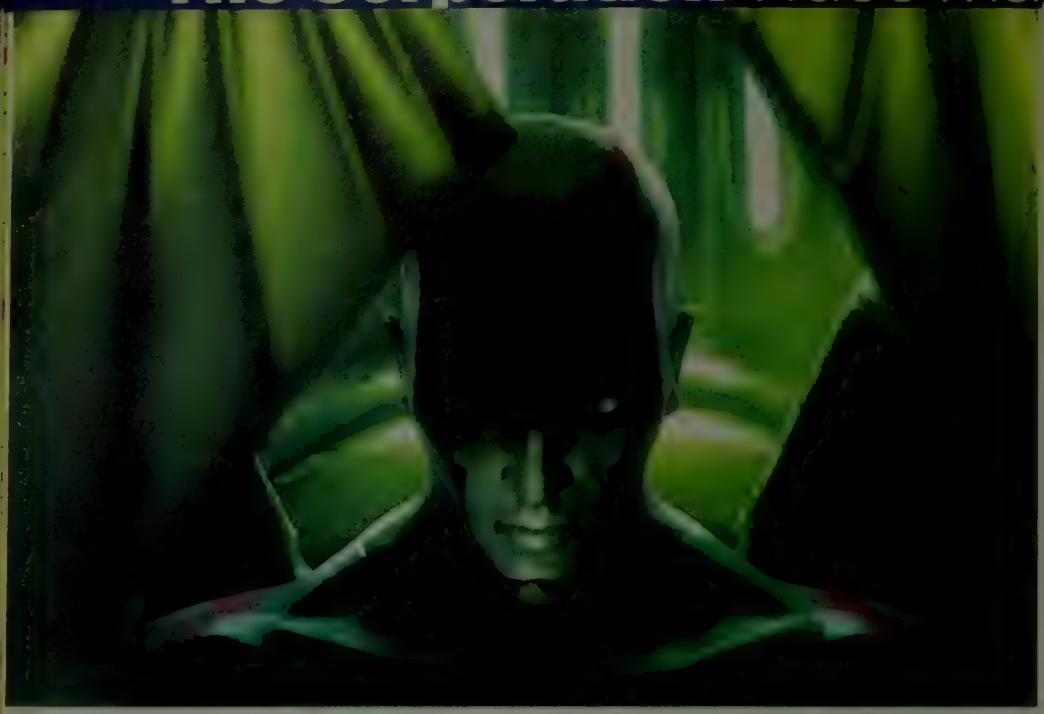


X-MEN LEGENDS 2 Avid gear grafts lifelike facial expressions onto game characters

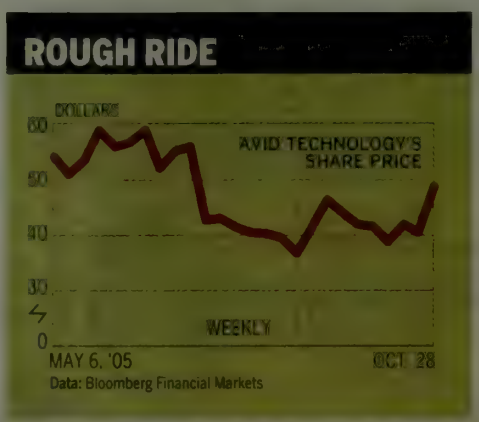
The Digital Hand Behind the Screen

Avid software is the tool of choice for creating TV shows, games, and movies

BY ARLENE WEINTRAUB

ON OCT. 25, AVID TECHnology Inc. CEO David Krall marched onto a stage at a swanky New York nightclub and smiled with anticipation as he unveiled his company's newest product. He pointed to a towering black cabinet stacked with 128 memory-filled engines—a $107,000-plus server named Unity ISIS—and explained how it will allow broadcast news stations and television production houses to store and share thousands of hours of digital video. "This is enough to give any geek goose bumps," Krall proclaimed.

Avid's ability to excite geeks has fueled an impressive growth spurt. Thanks to a string of acquisitions and deft product launches, the 18-year-old company has rapidly become a leading provider of digital tools for creating newscasts, television shows, movies, and video games. It counts among its customers such big names as Pixar Animation Studios, CBS News, and David E. Kelley Productions, creator of such TV hits as *Boston Legal*. Avid even boasts two Academy Awards for technical excellence. In the three years ending in May, the Tewksbury (Mass.) company's sales grew at an average rate of 10.9% a year, to $628 million, and profits ballooned 389% a year, landing the company at No. 46 on *BusinessWeek*'s annual Hot Growth list of the 100 fastest-growing small companies.



As all corners of the media industry—from news to gaming—continue to adopt the next generation of digital technologies, Avid's software and hardware have a chance to become crucial, must-have gear. Avid's digital editing software, for instance, has quickly become a favorite in the broadcast news business, where stations increasingly are ditching antiquated videotape-based editing systems. By storing video clips on Avid's servers, multiple editors can work on the same footage simultaneously. It's a far cry from the old days, when everyone working on a story had to pass around a single tape. "It makes producing the news a lot quicker," says Michael Chan, director of technical operations for NY1, a 24-hour Manhattan cable news network that has been transitioning to a totally tapeless newsroom using Avid's products. Piper Jaffray Co. estimates that only 26% of the 1,971 news stations in the U.S. have switched from tape to digital. Avid estimates that the rest could convert by the end of the decade.

HOT GROWTH COMPANIES

As is the case with many small tech companies, though, Avid is prone to getting beat up on Wall Street over unexpected slipups. In fact, earlier this year Avid's new Unity ISIS server was giving Wall Street hives rather than goose bumps. Krall and his team misjudged how long it would take to develop the server, so it hit the market a full quarter late and forced Avid to report second-quarter earnings in July that were a staggering 28% lower than what analysts expected. The company's shares plunged 28% in a day, from $55.30 to $39.8 But after a much better third quarter Avid's shares have rebounded, to $49.

Indeed, since the disappointing second-quarter news, Krall has been on a bit of a roll. On Aug. 9, Avid bolstered its position by acquiring rival Pinnacle Systems, which makes editing software for video pros and consumers. The $238 million deal will allow Avid to provide the software that news channels use to create the ubiquitous news "crawls" that run along the bottom of the TV screen, as well as a host of on-air graphics. And in September, Avid booked its single biggest news deal yet: CBS chose Avid's digital editing system for its New York

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and London newsrooms. The company won't disclose the amount of the deal, saying only that it's a multimillion-dollar score.

MAKING FACES

WHEN HE BECAME chief executive in 2001, Krall used Avid's technological expertise to expand its presence in other busy media fields, including the ultra-hot video-game segment. One of Avid's newest products, Softimage/Face Robot, helps animators imbue their characters with lifelike facial expressions. With Face Robot, game makers hook up sensors to real actors, capturing their grimaces and growls, and instantly graft the expressions onto their fictional characters. Los Angeles-based Blur Studio tested Avid's software while creating cinematic effects for the latest X-Men video game. "With our old system we couldn't get a realistic look," says Jeff Wilson, animation supervisor at Blur. "[Avid's tools] are the newest and freshest. Everyone else is tired and creaky."

Looming threats: Apple and Adobe

While Avid has a technological lead on rivals, well-heeled competitors are bearing down at every corner. The Pinnacle buy added consumer editing software, available at Best Buy Co. and other electronics stores. It's a top seller among proud parents and others who like to add Hollywood-style special effects to home movies. But rivals such as Adobe Systems Inc. have recently entered the fray. And on the broadcast and entertainment side, the formidable Apple Computer Inc. is starting to make inroads with its digital editing products, analysts say. "It's a manageable threat, but one Avid needs to watch," says Christopher Rowen, an analyst at SunTrust Robinson Humphrey Capital Markets. Rowen estimates Avid's 2005 sales will jump 32% over last year, to $776.9 million, and that net profits will rise 25%, to $93.6 million.

Krall has spent much of the fall meeting with investors to soothe frayed nerves after the ISIS delay. "Avid has been in the penalty box," he says. But if he can post the kind of performance that Wall Street is counting on, Krall is hoping that all will soon be forgiven. ■

Shoot the Focus Group

Advertisers are inventing new ways into the consumer's head

BY DAVID KILEY

"MY RESEARCH DEpartment doesn't know it, but I'm killing all our focus groups." So spoke Cammie Dunaway, chief marketing officer at Yahoo! Inc., at a Silicon Valley conference in September. Dunaway doesn't plan to harm the groups of innocents that marketers have long assembled in beige conference rooms to observe behind two-way mirrors, like zoo animals, as they hold forth about coffee and shampoo preferences. But she does want to put the two-way-mirror manufacturers out of business.

Yahoo has been getting little useful information from such groups, says Dunaway. She prefers "immersion groups" —four or five people with whom Yahoo's product developers talk informally, without a professional moderator typical of focus groups. That leads to work sessions in which a few select consumers work together with Yahoo staffers to actually design a new product. "The outcome is richer if they feel included in our process, not just observed," says Dunaway. One recent result: Yahoo is testing a new online community for car buffs who want more member-to-member opportunities to chat.

Exasperation with focus groups, while not universal, is growing as companies look for better ways to get inside consumers' heads, often assisted by new technology and the Internet. The dissatisfaction and the proliferation of new research approaches has been escalating so rapidly that the ad industry's main trade group has been spurred to conduct the first widespread study of testing methods since the 1950s.

Perhaps the most common complai about focus groups is that consumers a not honest in front of other peopl America Online Inc. in 2003 saw a di connect between what men revealed groups and the complaints about spam received by e-mail. It turned out th men, in a room with strangers, were n keen to admit they didn't have full con mand of their laptops. But in e-mail they conceded that they were tortured b underperforming spam blockers.

Observing and interviewing men their keyboards led to a revamp of t AOL blocker and an ad campaign pub cizing the change. "There's peer pressu in focus groups that gets in the way finding the truth about real behavior a intentions," says John B. Osborne, chi executive officer of BBDO, New Yo AOL's ad agency. Author Malcolm Gla well bashes focus groups of all kinds his latest book, *Blink: The Power Thinking Without Thinking*. "Aski someone to explain [their behavior a intent] is not only a psychological i possibility...but it biases them in favor the conservative, in favor of the know over the unknown," said Gladwell in speech to the ad industry last August.

FALSE POSITIVES

DESPITE THE COMMON assumpti that you don't know if an online chat is a teenager or a cocker spaniel, goi online to get at true consumer behavi

The Two-Wa Mirror Is Broke

Reaching consumers means chattin with them online or going to their h

I SPY Special glasses allow Kimberly-Clark to see what moms see

s drawing increasing interest from mar-
eters. Consider the conversion of Pepsi-
o Inc. to the new thinking: Pepsi
unched a new cola in 2004, Pepsi Edge,
hich tasted similar to original Pepsi, but
ith half the calories. Edge was green-
ghted in large part after focus groups
ndorsed the concept. But it was a classic
ase of a focus-group false-positive. The
lea made sense to people who switch be-
ween zero-calorie Diet Pepsi and the
riginal, but the murky positioning of be-
ng neither diet nor the original stirred lit-
e interest at the retail level.

Looking for better methods of predict-
ng consumer acceptance, Pepsi recently
urned to Stamford (Conn.)-based Invoke Solutions, which conducted several instant-message-style online panels of 80 to 100 people collected by its affiliated online survey firm, Greenfield Online. Pepsi delved into attitudes among Gen Xers toward drinking mineral water. In just a few hours, the beverage marketer was able to gather and process detailed feedback from hundreds of consumers. Getting a comparable result from focus groups would have taken several weeks.

Invoke is one of many firms popping up whose outreach to consumers is based on connecting via the Web. Reaching out online, through surveys or IM, shields people from the influence of a group and better enables different departments to eliminate blind alleys. At first, Pepsi marketers were jazzed that the group liked the idea of high levels of mineral content in water. But the beverage scientists on the scene squelched higher mineral levels; that would require adding sugar, which consumers didn't want, to make the taste acceptable. "Conclusions that could take three to four months to sort out through focus groups...get settled in a few hours," says Invoke Chief Operating Officer David Rubenstein.

Speed is just one of the appeals for political strategists shifting from traditional focus groups to online research. Mark Mellman, president of Washington's Mellman Group Inc., recently used Invoke on behalf of Planned Parenthood. A series of online panels totaling hundreds of people shared attitudes about U.S. Supreme Court Justice John G. Roberts Jr. and abortion rights, and inspired the messaging for ads. Mellman figures he'll use the method for candidates as well. The savings and speed, he says, lets him reach more diverse voters than focus groups allow—beyond those "who simply have a few hours on their hands and want the $50 fee."

Peer pressure can skew research about behavior

Some of the new solutions displacing focus groups don't rely on consumers to sort through their feelings at all. Instead, companies get more useful feedback just from watching daily life. In spring 2003, paper products company Kimberly-Clark Corp. saw sales of Huggies baby wipes slip just as the company was preparing to launch a line of Huggies baby lotions and bath products. Focus groups weren't yielding any compelling insights. Then a K-C senior packaging designer came up with a new approach: a camera mounted on a pair of glasses to be worn by consumers at home, so researchers could see through their eyes. "Letting us see what they see, rather than pointing the camera at them, proved more comfortable for them and useful to us," says Becky Walter, innovation and design chief.

It didn't take long to spot the opportunities. While women in groups talked about changing babies at a diaper table, the truth was they changed them on beds, floors, and on top of washing machines in awkward positions. The researchers could see they were struggling with wipe containers and lotions requiring two hands. The company redesigned the wipe package with a push-button one-handed dispenser and designed lotion and shampoo bottles that can be grabbed and dispensed easily with one hand.

The old-fashioned focus group still has its believers even with fiascoes like Pepsi Edge and a decades-long new-product failure rate of about 90%. Bonnie Goebert, author of *Beyond Listening: Learning the Secret Language of Focus Groups*, says, "Consumers aren't dishonest, it's that most people don't listen the right way." On the other hand, maybe consumers can be heard more clearly when nobody is watching. ■

RNET RESEARCH ELS

isers from Pepsi to politicians ning to online groups of ners who give feedback—-message and chat-room style.

IMMERSION GROUPS

Marketers ditch the focus group moderator and interact directly with consumers, involving them in product design.

ETHNOGRAPHY

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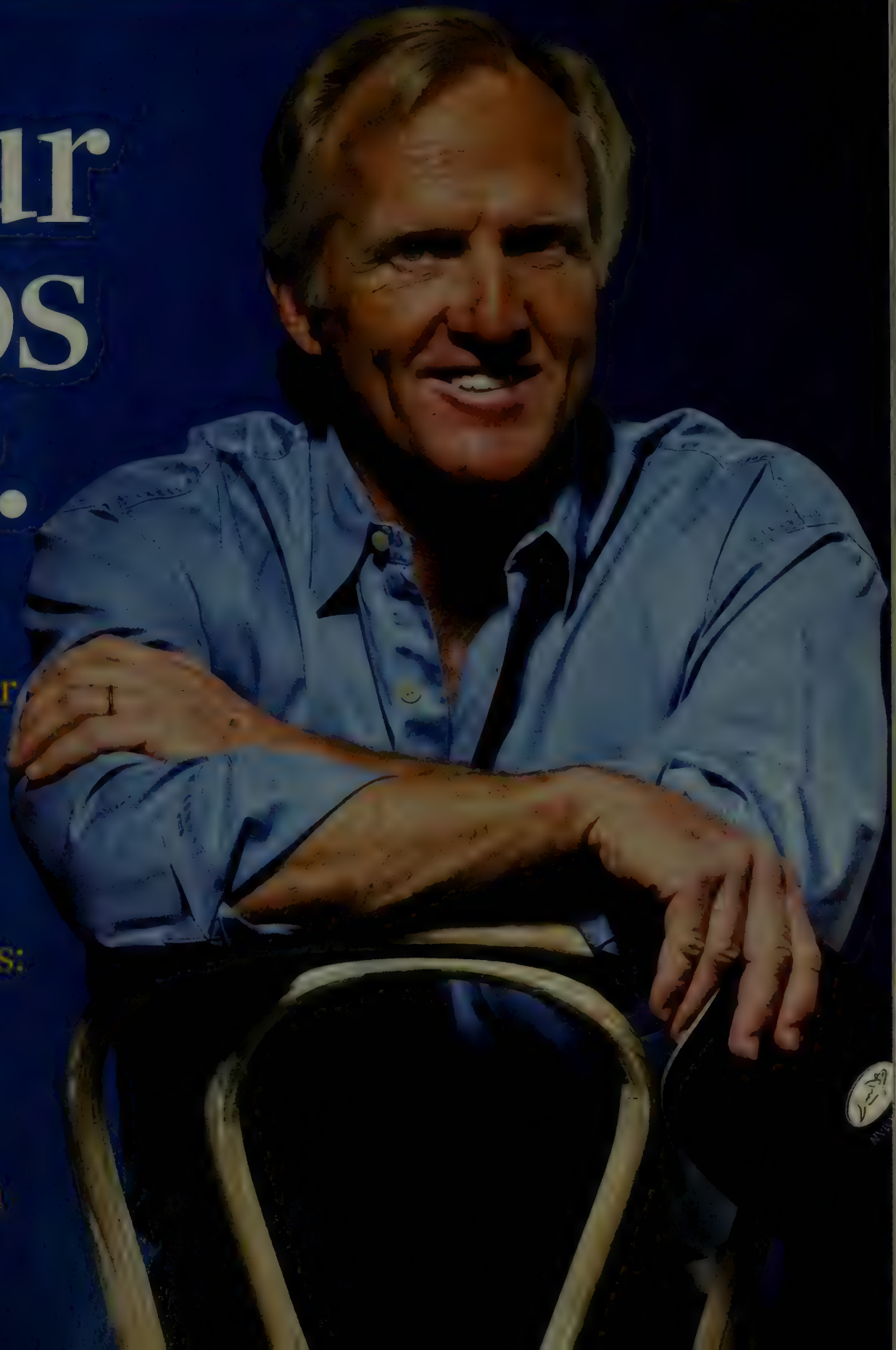

NORMAN MARKETS WINES FROM BOTH AUSTRALIA AND CALIFORNIA

It's a steamy summer morning and Greg Norman is itching to play golf. After back pain forced him to withdraw from the PGA Championship in mid-August, Norman is eager to walk 18 holes at the Medalist Golf Club near his Jupiter Island (Fla.) home to see if he has sufficiently recovered to compete in the Jeld-Wen Tradition Champions Tour tournament in Aloha, Ore., the next week.

But the round is full of interruptions—the kind any golf-playing CEO would appreciate. As Norman approaches the 12th hole, his cell phone rings with a call from Reebok International CEO Paul Fireman. Norman retreats to the shade and spends 20 minutes discussing Adidas-Salomon's pending buyout of Reebok—specifically, how it might affect the Greg Norman clothing line Reebok produces. On the next hole, Bart Collins—who oversees the day-to-day affairs of Norman's myriad business ventures—zooms up in a cart and pulls his boss aside for

Greg Norman All Business

»His empire runs the gamut from golf course design to wine

By Dean Foust

PHOTOGRAPH BY RJ MUNA; COVER PHOTOGRAPH BY ROBERT NELSON

an impromptu meeting.

After he putts out on No. 18, Norman can banish any thoughts of hitting a few more balls on the range. Instead, he heads directly to the clubhouse dining room, where a wine company executive is waiting to give him a final tasting of the new line of Greg Norman California wines that will hit retail shelves in the fall. After Norman murmurs his approval of the five varietals he's given to taste, he dashes off to dinner with the ghostwriter of a Simon & Schuster book he's working on for release next June. A golf instruction guide? That was the old Norman. In this book, Norman plans to offer management tips based on his experiences as a pro golfer and entrepreneur.

Despite winning 86 tournaments over his 29-year pro golf career, Norman might never shake the images of his collapse in the 1996 Masters, where he blew a six-stroke lead and lost to Nick Faldo by five strokes, or his failure to win more majors than his two British Opens. But in the business arena, Norman has achieved a level of success matched by few other golfers. As head of Great White Shark Enterprises Inc., Norman presides over a sprawling empire that spans everything from golf course design to winemaking to turf grass.

Greg Norman Enterprises

WINE Norman has a 30% stake in a joint venture with Foster's Wine Estates. Last year, their Greg Norman label had U.S. sales of 230,000 cases—or $23 million at wholesale—making it the best-selling premium wine from Australia. Next, they will roll out a line of California wines.

APPAREL Norman's Reebok-made clothing line stumbled in the '90s when department store chains dropped it to give more room to hot designers like Ralph Lauren and Tommy Hilfiger. But Norman is now stealing share in golf pro shops from rivals such as Cutter & Buck. Sales are around $90 million at wholesale and nearly $200 million at retail.

HOMEBUILDING A partnership with Australia's Macquarie Bank Ltd. has roughly 10,000 golf-course homes under construction in Australia, Mexico, and the U.S. The business is worth about $200 million, of which Norman owns 30%.

TURF GRASS The 10-year-old business has supplied the sod for more than 100 golf courses and major sporting events, such as the 2000 Sydney Olympics.

GOLF COURSE DESIGN Norman's design team is busy with roughly three dozen courses under development. His fee: $1.25 million per, with about half of that falling to the bottom line. While some Norman-built courses like Doonbeg Golf Club in Ireland have won acclaim, critics consider others too difficult for average golfers.

Data: *BusinessWeek*, Great White Shark Enterprises Inc.

More Hits Than Misses

HIS APPAREL LINE, the Greg Norman Collection, rings up nearly $200 million in annual retail sales, making it one of the most popular clothing lines endorsed by any athlete. His Greg Norman Estates, a six-year-old joint venture with Foster's Wine Estates, now sells 230,000 cases of Australian wine a year—a strong performance that has inspired Foster's to launch California wines under the Norman label as well. Medallist Developments, a joint venture between Norman and Macquarie Bank Ltd. of Australia, currently has more than 10,000 golf course homes under construction in the U.S., Mexico, and Australia, and is mulling an expansion to other parts of the globe. Setbacks—such as a Greg Norman-themed restaurant and a Paul Newman-like line of foods—have been relatively rare.

Norman's payoff has been huge: Claiming he was "virtually broke" early in his playing career, Norman, 50, now oversees a business empire generating more than $300 million in annual revenues. Although he's more than a decade past his playing prime, Norman still exudes a magnetism that appeals even to consumers who have never picked up a golf club. "Norman has done what few athletes are able to do to transcend his sport," says Eldon Ham, an adjunct professor of sports and law at the Chicago-Kent College of Law. "There's a little Crocodile Dundee in him, and in marketing, attitude is one of the traits you're selling."

It has been quite an odyssey for Norman, who as a young tour pro showed little interest in business matters. In *Shark: The Biography of Greg Norman*, author Lauren St John writes that a younger Norman sometimes fell asleep in meetings with prospective business partners—"bored rigid by the plotting and

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IRELAND'S DOONBEG GOLF CLUB IS AMONG THOSE DESIGNED BY NORMAN

planning he paid others to do." He only took interest after a couple of deals went awry. (Norman takes issue with this characterization.) As he began to win tournaments, he admits he paid a price for not paying closer attention to how other people handled his affairs. "Typical athlete, I got f---ed over by my agent and found myself in trouble with the Australian taxation office," he says. "But I learned an important lesson: Take control over your own money, your own destiny."

Even after signing with über-agency IMG in the 1980s, Norman grew dissatisfied with the hefty fees—10% of winnings and 25% of merchandising income—and what he felt was IMG's fast-buck mentality. "They don't take the long view because they're only working on a three- or five-year contract, and there's always another star right behind you," he says. "I didn't want to be playing golf beyond 65 because I had to." Tensions came to a head in 1993 after IMG demanded a cut of the $44 million Norman reaped as an early investor in clubmaker Cobra Golf after its sale to American Brands—a deal that Norman insists he'd negotiated himself.

»Norman has learned from the travails of other golfers-turned-businessmen such as Arnold Palmer

Going It Alone

SO IN THE EARLY 1990S, Norman, his popularity soaring, chose not to renew his contract with IMG and began managing his own affairs. Known for being hard on caddies, swing coaches, and disruptive galleries, he proved to be just as tough as a businessman: Biographer St John notes that Norman could be stinting with his praise and once didn't speak with his former top executive, Frank Williams, for three months during a tiff. (Collins says Norman has mellowed.) Some business partners say Norman can be just as exacting with them. "He's incredibly demanding," says Fireman. "He demands great product and innovation." But the Reebok CEO gives him credit for thrusting himself deeper into decision-making than most athletes—everything from approving potential clothing designs to long-term strategy. "He truly wants to build his brand for the long term, and that's a big difference from most athletes," Fireman says.

Over time, Norman says he made a point to study—and learn from—the mistakes of other pro golfers-turned-businessmen. For example, Norman believes Arnold Palmer might have cheapened his image by being too indiscriminate with his endorsements. "I could have endorsed car washes and underwear, but things like that don't build up your brand," he says. After studying Jack Nicklaus' well-publicized problems—a soured real estate venture left Nicklaus financially overextended in the mid-1980s—Norman decided to sharply limit how much of his own money he put into deals. "Jack was a strong enough brand that he did not need to put his own neck on the line," he says. In both his real-estate venture with Macquarie Bank and his winemaking partnership with Fos-

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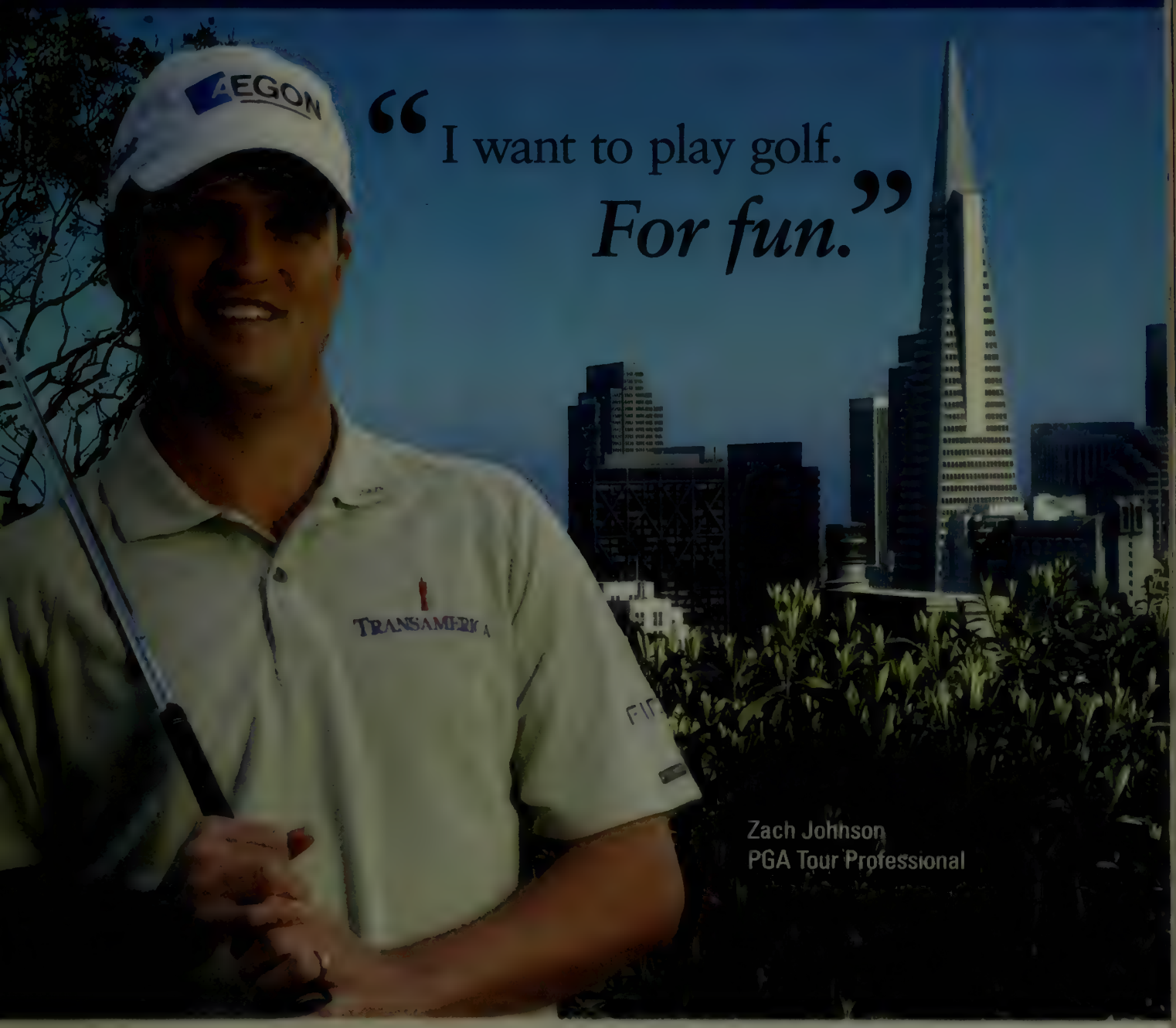

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ter's, Norman put up not a cent—and received a 30% equity stake in each just for lending his name and image. Late last year, MacGregor Golf sweetened its deal for Norman to promote its new Mactec driver and other golf clubs by giving the Shark stock options on top of his endorsement fee, says MacGregor CEO Barry Schneider.

Still, not all of Norman's ventures have panned out. In Australia, he scrapped plans to introduce a line of pasta sauces and other foods after the products generated mixed results in test markets. Collins says the food line was designed to be nothing more than a charitable venture à la Paul Newman, but "the message that it was cause-related never got through."

»A Paul Newman-style food line didn't fly, but setbacks have been the exception among Norman's ventures

NORMAN'S AUSSIE MYSTIQUE IS A HIT WITH FANS AND EVEN CONSUMERS WHO DON'T PLAY GOLF

After joining with restaurateur Todd English to create six Greg Norman's Australian Grille restaurants, only one—the original in North Myrtle Beach, S.C.—has opened. Collins acknowledges that Norman chose the wrong partner for the restaurant, which bled red ink from the beginning. But under a new management team, the restaurant has managed to turn a profit in each of the past two years, and Collins says Great White Shark Enterprises is planning to seek a major restaurant chain to expand the Australian Grille concept to other markets.

While the demand for Norman's golf course design service remains strong, critics contend his record as a course architect is mixed. Despite charging a relatively hefty $1.25 million design fee, Norman says he currently has about three dozen courses in some phase of development—a strong showing at a time when many other architects are scratching for business. To his credit, *Golf Digest* named his Doonbeg Golf Club, located on Ireland's rugged western coast, the "Best New International Course" in 2002. In the U.S., *Golf Digest* has put at least three Norman designs—Shark's Tooth in Lake Powell, Fla., TPC at Sugarloaf in Atlanta, and the Reserve in Pawleys Island, S.C.—on its best new course lists over the past decade.

But Norman has also seen two courses he built reworked or bulldozed by developers who deemed his layouts too challenging for average golfers. That was the case in Scottsdale, Ariz., where he designed a resort course known as Stonehaven for Lehman Brothers Inc. After Lehman sold the development to Discovery Land Co. of San Francisco—which immediately converted it to a private club—Discovery determined that the design was too demanding for members. "We saw the course as not being playable enough so we tore it up and started from scratch," says Discovery partner Steve Adelson. While the Norman layout had a mere 42 acres of fairway—meaning most wayward shots ended up in the desert—architect Tom Fazio created a much more forgiving 90-acre tract.

Such setbacks have been the exception throughout Norman's career as a businessman. He says his ultimate goal is to emulate the success of René Lacoste, a tennis star-turned-clothing designer from the 1930s whose legacy is the ubiquitous alligator logo. "Not many people know him for what he was—a good tennis player, not a great tennis player," says Norman. "But he created a brand that lives on. That's what you want to do, to leave a legacy, a trust in perpetuity for your children." Norman hopes that will be his final conquest. ■

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PGA TOUR

Ernie Els

Els, like fellow South African trailblazer Gary Player, easily leads professional golf in miles traveled each year. When he's not recovering from knee surgery, it is not unusual for Els to play tournaments—and win—on the PGA Tour, European tour, Sunshine Tour, and Australasia tour all in the same year. Basing himself near London and using a private jet positions him perfectly for travel. And his endorsement partners benefit greatly from the worldwide exposure he brings to their products. Annual income figures are listed here.

PHITEN
Els has worn this titanium necklace since early 2004.
Income: Less than $100,000

SAP
It gets the hat and chest (two spots in every photo) and lots of prime TV.
Income: $3 million

MERCEDES
Els canceled this deal—the five-days-a-year commitment to outings conflicted with his travel and family life.

OMEGA
The watch gets in all those hoisting-the-trophy photos.
Income: $250,000

FIDRA
With Cleveland Golf and Fidra now owned by the same company, Quiksilver, Els could be looking for a new clothing deal for 2006.
Income: Mid six figures

TITLEIST
It gets him for lower than the market rate by allowing him to sell his hat space to another company.
Income: $3 million

APPEARANCE FEES
$750,000 to $1 million a pop for non-PGA Tour events. Els plays up to 10 tournaments outside the U.S.

This player for hire

»From Ernie Els to Cristie Kerr to Dana Quigley, tour pros make a lot more than prize money

By Ron Sirak

IF THERE IS SUCH A THING AS A no-risk venture in sports marketing, it is the tour professional. First, no athlete provides so many opportunities to show off a company's logo as a pro golfer, simply because there are no uniforms. The fact that NASCAR drivers try to squeeze myriad logos onto their uniforms is probably a plus for golf. Having fewer logos brings more attention to the product. And then there is the point that golfers are standing relatively still when the TV camera is on them, giving the viewer a better look.

Second, the nature of the sport creates many business possibilities not open to team athletes. The pro-am experiences on all three major circuits—the PGA Tour, LPGA Tour, and Champions Tour—always rank at the top of any satisfaction survey of companies that invest in sports. Although Derek Jeter might be of value at a cocktail party, no client will ever get a chance to play baseball with him. Anyone who plays in a pro-am or even shares a few holes with a professional at a corporate outing has some great coffee-break conversation material for weeks.

And perhaps the best marketing hook for professional golfers is the stability of the game. "To be a successful sport you have to have a good television deal and labor peace," says David Carter, founder of the Los Angeles-based strategic-marketing consulting firm Sports Business Group. "And pro golf has both. There are no surprises. No strikes. No lockouts. What you pay for is delivered." Professional golfers also offer a near-spotless record in terms of police rap sheets. The fact that a player under contract is not a risk to bring bad publicity to endorsement partners is a strong selling point.

The PGA Tour, which is trying to juggle its schedule beginning in the 2007 season to better compete in the fall segment against football, has at least 10 more years of Tiger Woods, and fan interest will build as he closes in on Jack Nicklaus' major-championship record. The LPGA has its best player ever, Annika Sorenstam, and the talent pipeline is packed with such highly marketable youngsters as Paula Creamer, Morgan Pressel, and Michelle Wie. And the Champions Tour has a constant stream of talent moving over from the regular tour. Here are three top players and their endorsement deals.

LPGA TOUR

Cristie Kerr

With six career victories, Kerr has emerged as one of the best American women players. A radical physical transformation several years ago in which she lost 50 pounds has made her not only a better competitor, but has opened up a variety of endorsement opportunities. Only 28, Kerr is positioned to cash in on the surge of interest in the LPGA likely to come as talented teens Paula Creamer, Morgan Pressel and Michelle Wie bring attention to the women's game.

LACOSTE
[illegible] lucrative logo position. Such deals are loaded with performance bonuses. With five wins and 21 top-10s the last two years, Kerr should cash in big time.
Income: $500,000

GINN CLUBS & RESORTS
The left sleeve (under the sweater) is next in logo prominence, followed by the right sleeve, the yoke of the collar, and then the tab of the collar.
Income: $100,000

AUDEMARS PIGUET
The real value in this deal can come in product, with the player getting a couple of luxury watches a year.
Income: $25,000

TITLEIST/ FOOTJOY
$5,000 guarantee with $5,000 bonus for a win with its ball, and $1,000 for a top-10 finish.
Income: $45,000

OUTINGS
Kerr likely earns between $10,000 and $20,000 a day for appearances beyond her contractual obligations.
Income: $100,000

MUTUAL OF OMAHA
Kerr could earn $500,000 a year for a hat-and-bag deal, especially playing the way she has the last two years.

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CHAMPIONS TOUR

Dana Quigley

This guy might be the best deal in all of sports. He plays virtually every week (278 consecutive events for which he was eligible at one point) and is almost always on TV because he is usually in contention. Few players this side of Tiger Woods get as much logo time on the tube as Quigley. Also, his easy personality makes him a great pro-am partner. Quigley played in four Peter Jacobsen pro-ams this year, at $15,000 each. He plays in about 25 Monday pro-ams a year at $1,000 to $2,500 per outing. If a company wants to book him privately, Quigley starts listening for $5,000 and will jump at $10,000 for a one-day outing.

ALLIANZ
A company highly visible in golf. Quigley gives it four to five pro-am days a year.
Income: Low six figures

BOBBY CHAN APPAREL
Up to $50,000 with bonuses. With the kind of year Quigley had in 2005, he reached those bonuses.

TE-AMO CIGARS
Gets eight boxes of cigars per week.
Income: $15,000

EQUIPMENT
Has no official deal. Plays a variety of clubs, including a Gossin Rife 2 Bar Blade putter.

NETJETS
For carrying the logo, Quigley can fly NetJets to tournaments.

TITLEIST
Titleist pays him $10,000 for a win with its ball, $2,500 for a top-five, and $1,000 for a top-10.

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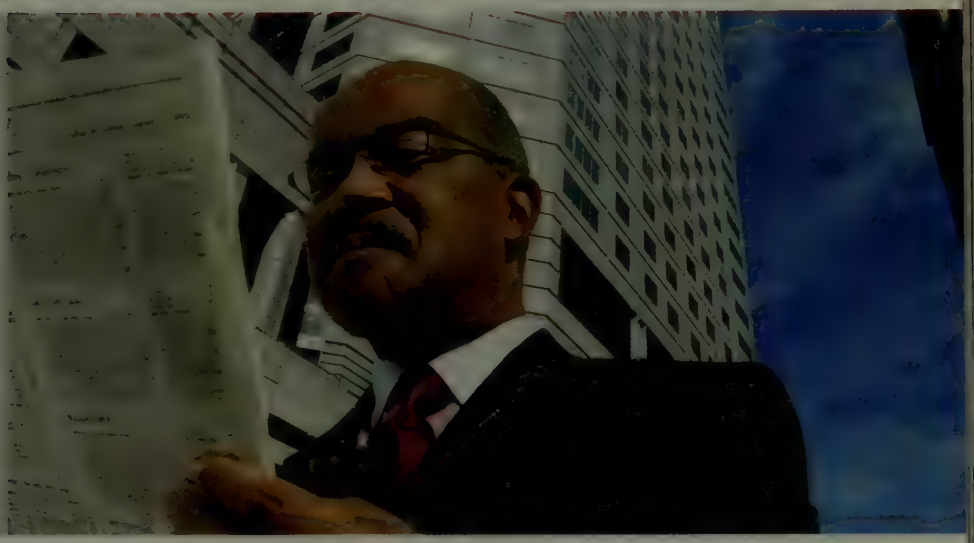

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»How much do PGA Tour players get when their careers are over? The figures might surprise you

By Matthew Rudy

A Tour Pro's Nest Egg

THE STROKE THAT BROUGHT Vijay Singh's $10.9 million 2004 season nearer to the $22.5 million Manny Ramirez earned playing for the Boston Red Sox or the $20 million Shaquille O'Neal made from the Miami Heat didn't happen on the golf course.

It came from a pen in a boardroom at PGA Tour headquarters back in 1983.

Long before the Tiger Woods phenomenon fueled a series of giant television contracts that pushed the tour's total prize money from less than $20 million in 1983 to nearly $250 million in 2005, former PGA Tour Commissioner Deane Beman devised a program that would reward the most successful, consistent—and loyal—tour players with a significant stream of deferred income.

How significant is this potential nest egg for the players? Very significant, but only if they're having a prosperous career.

By the time Singh turns 60, in 2023, the deferred money from his record-setting 2004 season could have mushroomed into nearly $4 million in extra cash in his pension account. And if Singh meets a complicated series of performance and activity benchmarks, he could be sitting on a fun-

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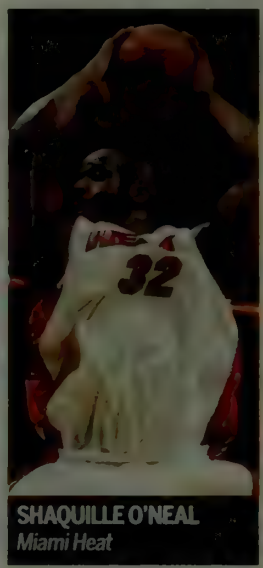
Professional Sports Pensions: How They Stack Up

THE PGA TOUR'S pension plan is performance-based, unlike the plans for other major sports, which pay out based on a player's service time. Because the tour's plan is a form of deferred compensation, players who perform well can expect a much bigger payday at retirement.

VIJAY SINGH
No. 2 player in the world

PEYTON MANNING
Indianapolis Colts



SHAQUILLE O'NEAL
Miami Heat

BRIAN GILES
San Diego Padres

TUOMO RUUTU
Chicago Blackhawks

	PGA TOUR	NFL	NBA	MLB	NHL
ELIGIBILITY	■ Voting members of the PGA Tour are eligible	■ All players who play four seasons (three after 1992)	■ All players who play at least five seasons	■ All players on a major league roster for at least 43 days	■ Players who appear in at least 160 league games
PLAN DETAILS	■ Players earn pension money for cuts made and earnings milestones ■ Pension money vests fully after five years of playing 15 events ■ Players begin collecting benefits at retirement from golf or age 60, whichever comes first	■ League pays a minimum of $200 per month per season played ■ Players can begin collecting full benefits at age 55 ■ No player contribution	■ League pays a minimum of $300 per month per season played ■ Players can begin collecting full benefits at age 55 ■ No player contribution	■ Payout is based on cumulative service time, beginning at $34,000 per year and escalating ■ Players can begin collecting a reduced benefit at age 45 or full benefits at age 65 ■ No player contribution	■ Players who appear in fewer than 400 games receive $8,000 per year starting at age 45 ■ Players who appear in more than 400 games receive $12,500 per year at 45 and a lump sum of $250,000 at age 55 ■ No player contribution

SOURCE: PGA TOUR; NFL, NBA, MLB, AND NHL PLAYERS' ASSOCIATIONS

worth tens of millions of dollars. Meanwhile, Ramirez will collect about $150,000 yearly in pension if he plays 20 seasons, and Shaq will have to get by on the $55,000 a year he'll receive if he plays 15 years.

What makes the tour's pension program the most lucrative in sports? It isn't financial alchemy or some kind of elaborate pyramid scheme. It's more the power of compound interest.

The fundamental difference between the PGA Tour's plan and those of the other sports leagues such as the NFL, NBA, Major League Baseball, and the NHL is in the way the tour's plan is funded. Player payouts in the NFL, NBA, MLB, and NHL pension programs come solely from television revenue invested by the league. Those programs are designed to be safety nets for players who didn't earn large salaries or have long careers. A baseball player needs just 43 days of major league service to qualify for a $34,000 annual benefit. The NFL's plan covers every player who played at least four seasons in the league, and the NBA covers those

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who played at least five. The NHL pays a pension to players who played in at least 160 games (table, page 140).

The PGA Tour's program works more like a deferred-compensation plan than a pension. Funds for the pension—$28.5 million out of a purse of $250 million in 2005—are allocated by the PGA Tour Policy Board from the tour's annual revenue. "Players give up compensation in the short run for these programs to be as good as they are," says Beman, who was commissioner from 1974 to '94. "There's always a negotiation about how much you can do in terms of funding it, but the players recognized this was the best for everybody. It's also an advantage not to be dealing with a player-union situation, like the other leagues."

The Lesson: Keep On Making Cuts

ONCE A GOLFER PLAYS FIVE FULL SEASONS, the power of compounding interest really begins to work in his favor. This chart compares the estimated pension payouts awaiting a journeyman, an established 20-year player with a handful of wins and a star who earned significant performance bonuses.

	PLAYER A	PLAYER B	PLAYER C
CAREER CUTS	150	400	400
YEARS ON TOUR	15	20	20
WINS	1	4	15
AVG. PENSION CONTRIBUTION PER YEAR	$50,000	$100,000	$500,000
PENSION VALUE AT AGE 60	$3.9 Million	$9.5 Million	$48.5 Million

Assumptions: 6% annual return, 3% annual inflation, $3,800 contributed per cut, $7,500 after 15 cuts

How the PGA Tour plan works

ESSENTIALLY, A PLAYER'S pension account is seeded with money he would have otherwise collected by making cuts when he was playing, augmented by performance and participation bonuses and then distributed to him after he retires. However, the player has to maintain a certain level of performance to collect all of the cash at retirement. The player-contribution component, coupled with a dramatic increase in purse sizes during the last 10 years, has made a core group of high-achieving tour players wealthier than they already are—at least on paper.

"It's just a better way to pay people," says Beman, who devised one of the first IRS-approved deferred-compensation plans while working in the employee-benefits business in the 1960s, before his PGA Tour career. "From a player perspective, it's good to divert as much money as possible—that's pretax money growing in the pension account. The NFL player is taking his money up front and asking the league to subsidize his retirement later on. He's also got an agent involved, who is interested in getting as much money up front as possible. PGA Tour players are taking a longer-term view."

»For the players, it's good to divert as many pretax dollars as possible

Tour players bank money in their pension accounts three ways:

1. For each cut made during the season.
2. Performance in each of three schedule segments during the season.
3. Position on the end-of-season money list.

At the beginning of the year, the PGA Tour Policy Board designates a pool of money for each element of the pension program, to be divided among the players who qualify by their performance.

The original component of the pension is the cuts plan, which is open to voting members of the tour who play in 15 or more official events in a season. Each cut made during the season has a pension-contribution value. For 2005 the contribution per cut is $3,800, and that figure doubles for every cut made after the 15th. The catch is that a player must play a minimum of 15 events as a voting PGA Tour member for five seasons before he's fully vested in the cuts element of the plan—making the fifth season of membership the magic number for every tour player.

"The concept of this program was that it should be helpful to the players who made the tour what it is," Beman says. "It's designed to get marquee players to play more. It's not a reward for guys who are just trying to make it."

To boost the original cuts-made plan's ability to motivate players to enter more events, the tour added the player-incentive component in 1998 and the deferred-compensation bonus program to the pension package in 1999. The player-incentive plan breaks the schedule into three segments. Each segment has a pension bonus pool—$2 million in 2005—that is distributed roughly the same way as prize money from a tournament. The player who earns the most prize money in a given seg-

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ment receives 18% of the bonus money in his pension ($360,000 in 2005), the second-place earner receives 10.8% of the pool, and on down the list. To collect 100% of his incentive bonus money, a player has to play 100 official events over four years or play in each official event on the schedule at least once in a four-year stretch. He can also increase his vesting percentage by increasing his "historic playing average"—the average number of tournaments he plays in a year—over four seasons.

"You can see how it's an incentive for the younger guys to bump their fall schedule," says Nick Price, who became fully vested in the original component of the pension plan in 1991. "When I was playing a lot in the late 1980s and early 1990s, the money I made on the golf course far outweighed what I could do in my pension, which took some of the incentive out of playing a lot of events. But for a guy like Charles Howell III, there'll be an actual comparison between pension money and career earnings. If they manage it correctly—not like Social Security—guys in their mid-20s who have a career like mine are going to have $30 million or $40 million in the pension. That's not too bad, especially compared to the early 1980s, when we didn't have anything."

PGA Tour Pension Plan

(2005 breakdown)

TOTAL PLAN FUNDING: $28.5 million

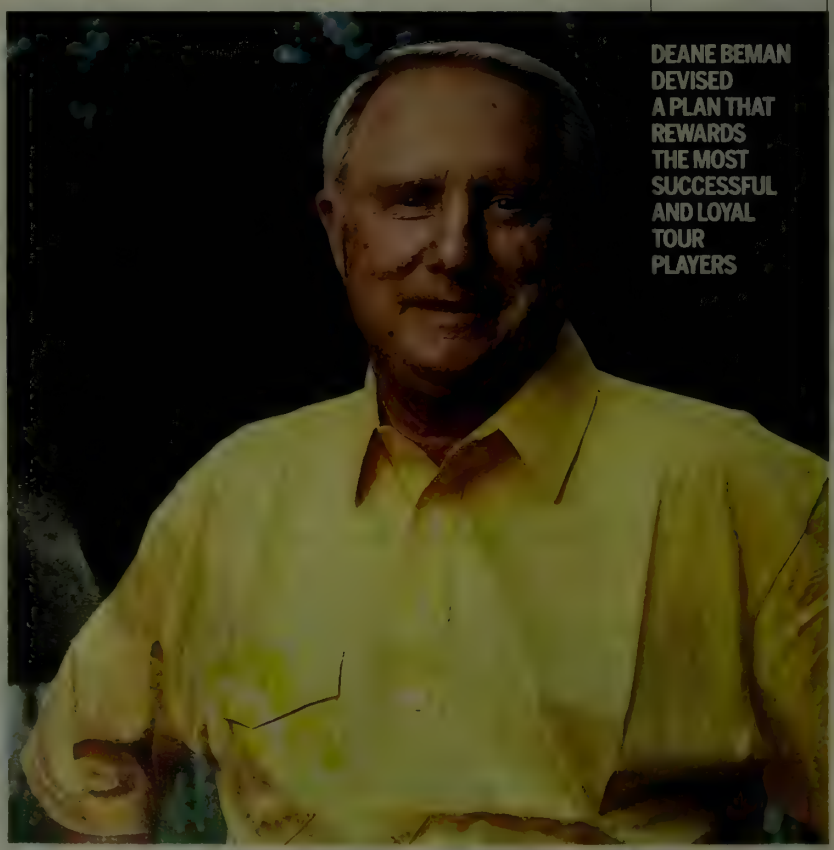
$3,800 per cut made (doubled after 15 made cuts)

$360,000 for earning the most money in any of three schedule segments

$100,000 for winning money title

The last segment of the plan is a straightforward bonus for a player's finish on the money list. In 2005, $10.5 million will be distributed among the top 150 official money-winners, with the money leader receiving $100,000. That money is immediately fully vested in the program.

By any measure, Singh's 2004 season was a great one. He won nine times and broke the tour's season earnings mark by almost $2 million. But in terms of pension contributions, it was the greatest in the history of the tour. Not only did Singh earn segment and money-list bonuses, but he also played in 29 events and made 28 cuts. The tour does not disclose player pension figures, but Singh's pension take from 2004 can be conservatively estimated at nearly $1 million—more than $700,000 in fully vested segment bonuses, $100,000 for his position on the money list, and $155,000 simply for making cuts—just one more reason to call him the hardest working man on tour.



DEANE BEMAN DEVISED A PLAN THAT REWARDS THE MOST SUCCESSFUL AND LOYAL TOUR PLAYERS

Not everyone benefits

THE TOUR'S PLAN, however, draws a very distinct line between the haves and have-nots. For example, Stan Utley has played in 196 PGA Tour events since 1988 and has made 80 cuts. He won the 1989 Chattanooga Classic on the PGA Tour and three other events on the Nationwide Tour. And unless he thrives on the Champions Tour starting in 2012, he'll be on the outside looking in. Players who did not contribute to the plan—either because they did not play enough seasons, or because the prize money they earned came before the plan was started—are pretty much left out. "The pension doesn't even enter my thinking," says Utley, 43, who has earned nearly $675,000 in career money. "I just looked at my last statement and there's nothing in there. I pretty much know I'm on my own when it comes to my retirement."

For the generation of legendary players—including Arnold Palmer, Jack Nicklaus, Lee Trevino, and Gary Player—who missed out on the regular tour's huge potential pension payouts because they were active before the program was formed, Beman created two "amnesty" programs. The first one was the Champions Tour, which made millionaires out of players like Orville Moody, who

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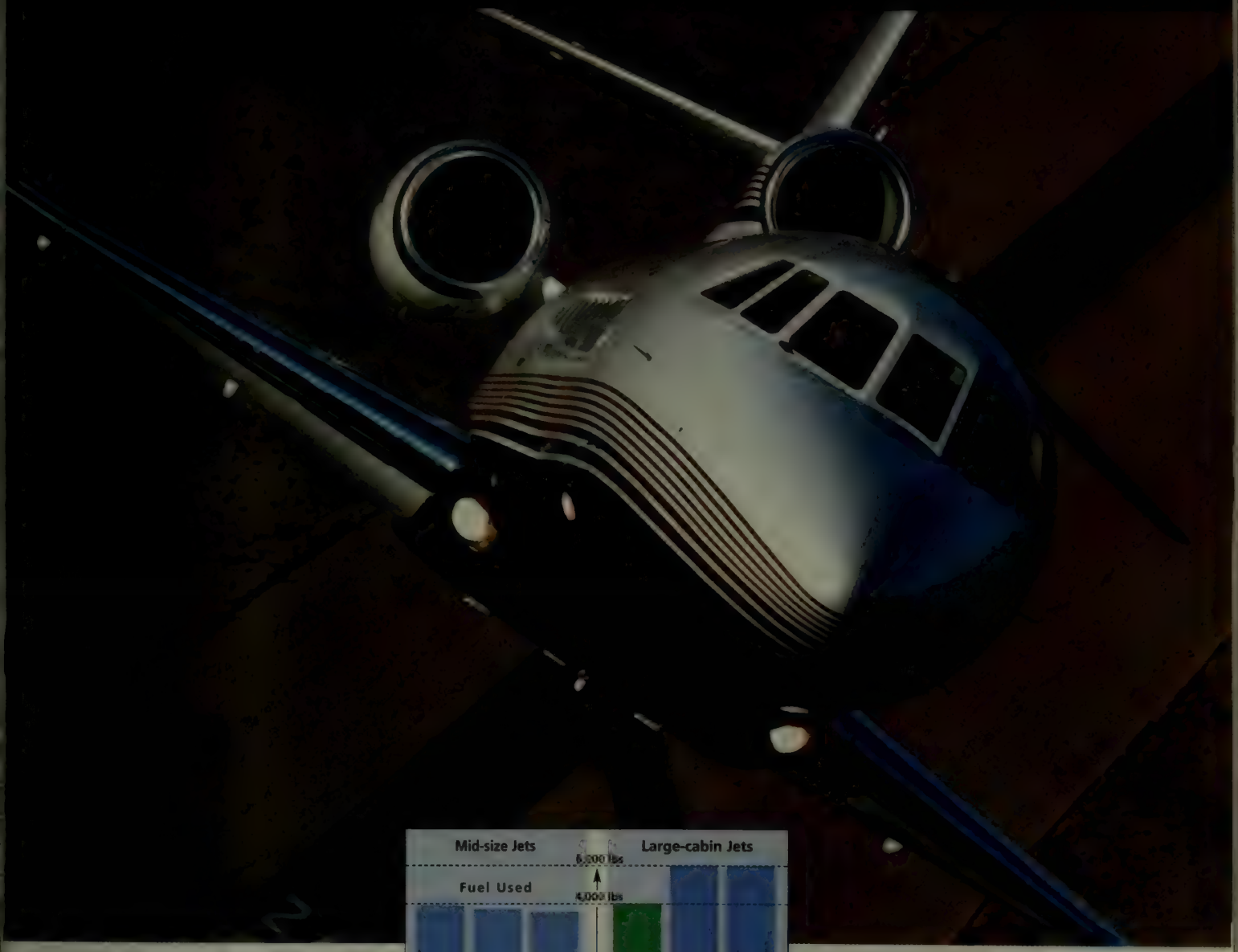

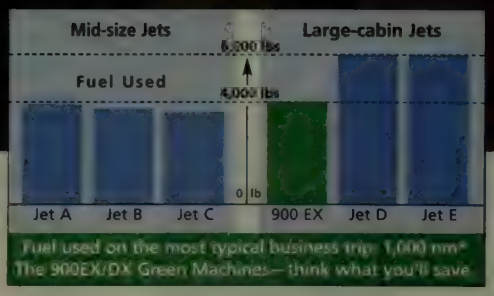

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hadn't had a lot of regular tour wins, and multimillionaires out of the likes of Trevino, Ray Floyd, and Dave Stockton. The second was an offshoot pension plan for senior players, which is based on the number of top-48 tournaments a player accumulates. Palmer and Nicklaus won't be able to blow off course-design work and live on the pension money they'll collect from the senior version of the plan, but they will get some payback for decades of brand-building in the name of the tour.

The tour manages its pension much like a corporation would a 401(k) or deferred-compensation plan. The money a player earns in the program stays on the PGA Tour's books until it is disbursed, at age 50 if a player has retired from competitive golf, or at 60 if the player stays active on the Champions Tour. Rank-and-file players don't have any control over the amount of money allocated to the pension program each year or how the pension money is paid out—in equal installments depending on when the player retires. However, they can control the mix of investments in their accounts, choosing from a menu of 12 Policy Board-vetted alternatives ranging in risk from equities to fixed-income bonds.

Players can request from the tour's finance and administration department customized pension projections that take a number of factors into consideration—competitive performance, length of career, market performance, the level of contribution from the tour, and the investment choices a player is making in his plan. "Assumptions on competitive performance and performance over time are critical ones when you make projections," says Ron Price, the PGA Tour's chief financial officer. "That's something we do routinely with players, getting input from them. We might go best-case scenario, likely case, worst-case scenario with a player, to give him an idea of where he is retirement-wise."

» Elite players like Vijay Singh could have a pension worth millions of dollars

According to Joe Ogilvie, who earned an economics degree from Duke before qualifying for the tour in 1998, the tour's management of the plan has been first-rate. "It couldn't be easier to research and change allocations," says Ogilvie, who finished 49th on the money list in 2004. "Charles Schwab runs the program for the players, and the tour hires an outside consultant to pick the mutual funds we can invest in. They just switched us out of one S&P 500 Index fund and into another because the fees were 15 basis points lower. That's good service."

Ogilvie estimates that a player would need to play 12 years, making 12 to 15 cuts per year and staying in the top 125 each year, to be fully set up in his retirement. "Obviously, set for some people is different than set for others," Ogilvie says. "If we have go-go years like we did in the 1990s—which we probably won't—that could halve that time frame. But I know some pretty smart people on Wall Street who say if you get a chance to lock in 6% for the next decade, you should take it in a heartbeat."

Perhaps the biggest risk to the pension plan's rate of return doesn't have anything to do with the investment options players pick. The tour's level of contribution to the plan has grown right along with purse sizes—an increase of more than 1,100% since 1983. But the era of huge increases in the size of the tour's television contract, and the related jump in prize money, is probably over. "We're seeing a leveling off of the television contracts in every sport," Beman says. "Golf isn't any different. But the basic underlying value of what golf brings to sponsors is still substantial. There's value there, and that will drive the program going forward." ■

JOE OGILVIE BELIEVES 12 GOOD YEARS ON TOUR WILL SET HIM UP FOR RETIREMENT

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BusinessWeek | Golf Digest GOLF & THE BUSINESS LIFE

A Round With Paul Clark

»Teeing off with the CEO of ICOS, maker of Cialis, one of the chief sponsors of the PGA Tour By Roger O. Crockett

PAUL N. CLARK RARELY plays business golf. But though he generally eschews entertaining customers or employees on the fairways, golf is still business for Clark. The CEO of ICOS Corp., maker of Cialis, the erectile dysfunction pill, attributes a good share of the drug's $1 billion in cumulative sales to the sport. That's because for the past two years, Cialis has been among a handful of chief sponsors of the PGA Tour and the title sponsor of the popular Cialis Western Open near Chicago.

When Clark's U.S. marketing team proposed golf as a means of pitching Cialis, he immediately supported the idea—and not because he has enjoyed the game since he took it up as a kid. He believed golf was a perfect fit for the product. The edge Cialis has over rival erectile dysfunction drugs, he claims, is its 36-hour window of effectiveness. In his view, Cialis is about relaxation. Its users can take their

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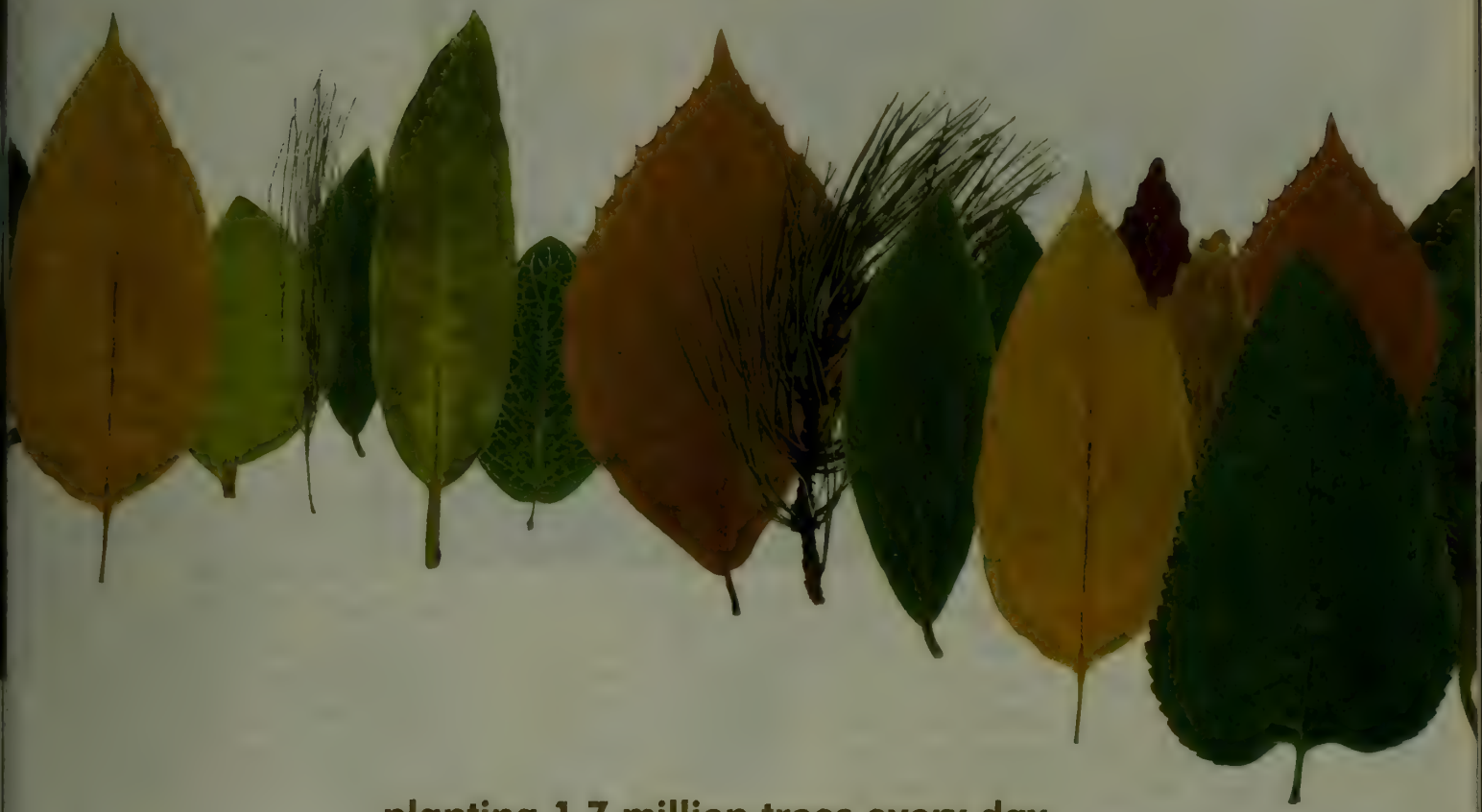

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(R TO L) CLARK WITH WRITER CROCKETT AND FRIENDS BRADY AND ROBINSON, AT THE SEATTLE GOLF CLUB

time finding the right moment for intimacy—making it more compatible with golf than with other faster-paced sports, he explains. Unlike, say, the basketball court, "there is no rush on the green," Clark says. "It's a natural tie-in to the message we're trying to send. With Cialis, you don't have to feel like you're on the NBA shot clock."

A Second Wind

SINCE HE PENNED the sponsorship two years ago, Clark has played the Western's annual pro-am with Tiger Woods. It's a thrill for Clark, a "dream come true for an average golfer," he says. But his bigger thrill comes in helping realize the dreams of participants in the Evans Scholars Foundation. As a Western Golf Assn. board member, Clark is a key supporter of the foundation, which funds scholarships that send caddies to college. During his greenside TV interview at the conclusion of each Western Open, Clark talks about the importance of the scholarships. And during the pre-tourney pro-am, he's like a proud father, reveling in the opportunities the scholars get to mingle with the pros. Clark mentions a conversation he and a young female caddie had with Woods about his 1997 Master's victory. Woods recalled the exact clubs he used to eagle the 13th hole and take the lead. "Three-wood, 8-iron," he said, as if it were yesterday. The young caddie wondered out loud how Woods remembered those details after eight years. Flashing that luminous grin he said simply, "I'm Tiger Woods." According to Clark, "It was a nice moment for her and for me."

Clark, 58, first took up golf while he was a teen. His father played, and he sparked an interest in his son. Not drawn to basketball, baseball, or football, and a bit bored with school, Clark soon took some lessons and began focusing on golf while attending Deshler High School in Tuscumbia, Ala. He went on to earn a bachelor's degree in finance from the University of Alabama and then an MBA from the Amos Tuck School of Business Administration at Dartmouth College in 1971. He took a job out of business school as a financial analyst at Union Camp Corp., fully expecting to forge a career in finance. Then, by what he calls "dumb luck," Clark fell into the world of pharmaceuticals. He applied for a job as a strategic planner for Sandoz Ltd., now Novartis Corp., in 1973 and never looked back.

Pharma offered many opportunities for Clark. At Sandoz, he crisscrossed the country working in a variety of jobs, from research to sales. He even spent a year's sabbatical in the early 1980s working as assistant to the then-director of the CIA, Stansfield Turner. He went on to become vice-president of sales and marketing at rival Marion Laboratories. Under the demands of work, golf had become a hobby he rarely had time for. That was until the mid-'80s, when he landed the job as

Paul N. Clark

CEO of ICOS Corp.

BORN Jan. 3, 1947 in Tuscumbia, Ala.

FAMILY Lives in Seattle with Carolyn, his wife of 34 years; two grown daughters, Ashley and Lindsey.

EDUCATION B.S. in finance, University of Alabama, 1969; MBA, Amos Tuck School of Business Administration at Dartmouth College, 1971.

CAREER Made his name as a top executive at Chicago-based Abbott Laboratories before joining ICOS as CEO in 1999.

MOST MEMORABLE ROUND Playing with Tiger Woods in the 2004 Cialis Western Open Pro Am. Despite shaking with nervousness on the first tee, Clark smacked his drive down the middle of the fairway.

LOWEST SCORE 79 about 10 years ago at Conway Farms, a Tom Fazio course in Lake Forest, Ill.

HANDICAP INDEX 15

Technical ability is crucial, but you need determination and mental strength to make it happen. rbs.com

Make it happen

RBS
The Royal Bank of Scotland Group

president of Abbott Laboratories' pharmaceutical division. Working and living north of Chicago, he joined Conway Farms Golf Club and later the Onwentsia Golf Club. Soon, he was taking lessons from the club pros and playing about 25 rounds a year. A legit golf buff by then, Clark developed into the 15-handicapper he is today.

Despite not playing on a weekday all summer long, Clark agrees to tee it up at his home course, the Seattle Golf Club, on a drizzly Friday afternoon in September. A couple of friends join him—Larry D. Brady, CEO of Everett (Wash.) tech firm UNOVA Inc., and Lloyd B. Robinson, director of On Call Physician Services at Concentra Inc. and former president of the Seattle Golf Club.

Clark appears relaxed as he steps to the first tee. After all, a few friends and a reporter pale next to the throng of fans and photographers lining the box during the Western's pro-am. The Cialis chief strokes his first tee shot about 240 yards down the right center of the fairway.

Clark plays as if the towering Douglas fir trees and spruce trees bordering the fairways don't exist. But the 105-year-old Seattle Golf Club, nestled into the hills north of Emerald City, demands target golf, and the lush environs don't spare Clark. His 5-iron to the first green flirts with the trees and lands awkwardly in one of the massive bunkers. Three shots later, he records a bogey 5. "I'm an average golfer," he says. "I'll be lucky if I play average today."

Strong Suit

ON HOLE NO. 3, after cracking another drive 250 yards uphill, he shares the secret behind his recent streak of long, straight drives. Playing with Clark earlier this summer, Woods asked to check out his new TaylorMade r7 driver. Tiger grasped the grip and gave it a once-over. Clark offered to let Tiger try it, but Woods declined, saying that the regular flex shaft would cause him to send the ball sailing straight right. Still, Clark boasts now: "Tiger Woods touched my driver!" The superstar mojo has been helping Clark strike it sweetly ever since.

A combination of solid drives and consistent irons keep Clark on top of his game the entire front side. But it's really the wedge game that is Clark's strong suit. He proves it on the scenic par-5 No. 9 by hitting an 80-yard shot to within 15 feet of the pin. Then he proceeds to take care of his tricky downhill putt, cozying it into the cup for a birdie 4 and an impressive front-nine 40, just four over par.

For a man who plays to relax, Clark tends to fidget during his pre-shot routine. It consists of repeatedly lifting his head to peek at the hole while he stands over the ball. Then without warning, he swings. He's the consummate host: tending flags, explaining the hidden vagaries of holes, and generally worrying about his partners' balls as much as his own. Maybe that's why he slips to nine over par on the first seven holes of the back side.

But Clark manages to peak at the right time. He closes with two pars, including a 15-foot putt on 18 to record an 85 for the day, two strokes below his average. Reflecting on why he enjoys golf, Clark turns philosophical. "Golf is a good teacher of humility and tenacity, and it teaches you about bad bounces," he says. It also teaches you how to relax. That's a lesson the Cialis CEO fully endorses. ■

8.2 Megapixel CMOS Sensor | 5 Frames Per Second | 9-Point Wide-Area AF | DiGIC II Image Processor | Hi-Speed USB 2.0 Data Transfer | 0.2 Second Startup Time | Compatible With 50+ EF & EF-S Lenses

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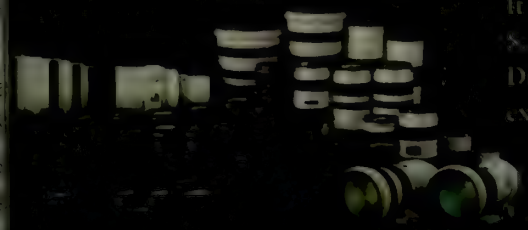
A camera with enough sophisticated features to satisfy even the most demanding professional photographer. Yet its most remarkable attribute just might be that all this creative control is available in a camera designed for the serious amateur.

Just look at what the EOS 20D offers. It reads like a professional wish list: 8.2 megapixels, 5 frames per second, the DiG!C II chip, magnesium alloy body, extended battery life, compatible with over 50 EF lenses. Not to mention 9-point wide-area AF, loads of customizable settings and a pop-up flash. Imagine getting all this creative control in a rugged, comfortably designed, easy-to-use camera.

In fact, with this level of control and creativity, perhaps there's one more thing we should include with the EOS 20D – "Working Press" credentials.



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BY GENE G. MARCIAL

FURNITURE IMPORTS MAY WEAR DOWN ETHAN ALLEN INTERIORS.

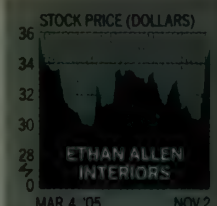
WYETH COULD BE SWALLOWED BY A PHARMACEUTICAL BIGGIE.

STUDENT LOAN FEES HAVE FIRST MARBLEHEAD REAPING PROFITS.

Ethan Allen Sags

ETHAN ALLEN INTERIORS (ETH) is probably the best-run furniture designer and maker—remaining profitable while many competitors are struggling just to keep above water. But deteriorating industry fundamentals fueled by low-cost, high-quality furniture imports (page 96) threaten to crimp company expansion. "We expect Ethan Allen's growth rate to decelerate and its price-earnings multiple to contract," warns Robert Plaza of Zacks Equity Research, mainly because of global overcapacity and price deflation in the industry. That has forced Ethan to reduce prices to retain its market share. And rising interest rates could hurt housing starts—and furniture sales. So he rates the stock a "sell" since he expects it to tumble in six months, from its current price of 34 to 28, or 14 times his earnings forecast for fiscal 2006, ending June 30, of $2.38 a share, vs. 2005's $2.19. For fiscal 2007, Plaza expects only $2.45. His profit estimates are less than the consensus. Ethan posted good results in the quarter ended Sept. 30, but Plaza credits much of that to increased share buybacks that reduced shares outstanding—thus lifting earnings. Another big bear on Ethan is Laura Champine of Morgan Keegan. Many of its franchisees are not doing well, she notes, in part because of rising U.S. imports of Asian furniture. She expects Ethan to buy out struggling franchises to consolidate stores. That can only dent margins, says Champine, who urges sale of the stock on "deteriorating industry fundamentals and valuation." Ethan sells its products at 311 retail stores—it owns 129, and the rest belong to independent dealers. CEO Farooq Kathwari told analysts that their second quarter and 2006 estimates are "within reach."

A TUMBLE MAY LIE AHEAD



Data: Bloomberg Financial Markets

30 Blue Chips in on

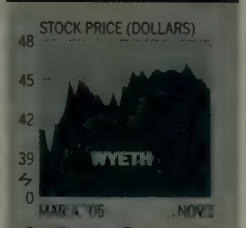
Diamonds (DIA) are all 30 gems of the Dow Jones Industrial Average wrapped up in one neat exchange tradec and of course, they are subject to similar risks. Ask your advisor for details. It's a smart way to add luster to your po

An investor should consider investment objectives, risks, charges and expenses of the investment company carefully before inv read the prospectus carefully before investing. *Usual brokerage commission applies. Dow Jones Industrial Average,℠ The Dow® and Di with Dow Jones. Diamonds are not sponsored, endorsed, sold or promoted by Dow Jones and Dow Jones makes no representation regarding the ad ALPS Distributors, Inc., a registered broker-dealer, is distributor for the Diamonds Trust, a unit investment trust.

Rivals Are Eyeing Wyeth

DRUGMAKER WYETH (WYE) is "the most attractive in the beleaguered pharma sector." So says Jeffrey Kleintop of PNC Advisors, which owns shares. One reason: It's lluring buyout bait. Wyeth is No. 3 in iological-drug capacity, an asset he ays is attractive to Big Pharma. Pfizer, laxoSmithKline, and Novartis have xpressed interest in expanding their iotech capabilities, says Kleintop, and ney see Wyeth as a way to do that. He uts the value of Wyeth, now selling at 4, at 55. Wyeth, argues Kleintop, is less ulnerable to generics than the bigger rugmakers, many of whose patents are ue to expire soon. The patent of Vyeth's big-seller, Effexor, an ntidepressant, will expire in 2008, but Wyeth has in its pipeline n alternative to Effexor, says Kleintop, who sees Wyeth earning 2.94 a share in 2005 and $3.18 in 2006, up from $2.65 in 004. Andrew Foreman of Friedman, Billings, Ramsey Group, ates Wyeth a strong buy. Wyeth says "it is well-positioned to ucceed as a stand-alone company." Novartis declined omment. Pfizer and Glaxo did not return calls.

STAYING WELL ABOVE WATER



Data: Bloomberg Financial Markets

First Marblehead: Solid

FIRST MARBLEHEAD (FMD), which processes student loans for banks and private lenders, hit 73 in March but has since tumbled—to 21 on Oct. 7—in good part because of missed sales targets and worries that the new bankruptcy law will deter students from borrowing (page 76). Now the stock is back up to 32. Carl Birkelbach of Birkelbach Management was quick to buy in. "The stock has huge upside potential as earnings continue to ratchet up," he says. Since 2001, when First Marblehead went public, earnings have shot from 4¢ a share to $2.39 in fiscal 2005, ended June 30. For 2006, Standard & Poor's sees $3.10. First Marblehead collects fees from banks and other lenders for servicing their student loans. Birkelbach predicts the stock will hit 43 in a year. On Sept. 28, Chairman and CEO Daniel Meyers had to quit after it was learned that he had exchanged gifts with an employee (since resigned) of Bank of America, a major client. The stock reacted—investors feared BofA might cancel its contract. But Birkelbach doubts BofA would pull out. And so far, no such thing has happened, notes Joseph Halpern of Halpern Capital, who owns shares and rates the stock "outperform." The stock trades at nine times 2005 profits He sees it climbing to 46, or 15 times projected 2006 earnings. "Given the robust earnings in 2006, a 15 p-e ratio is "conservative, at the least," says Halpern. Zacks's 2007 consensus estimate is $3.51 a share. ■

IS THE LONG SLIDE OVER?

Data: Bloomberg Financial Markets

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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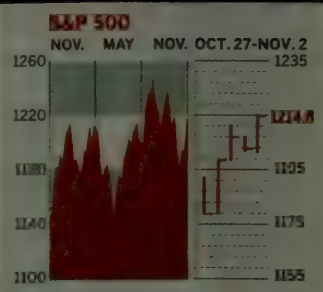
Personal Business Figures of the Week

STOCKS



COMMENTARY

After falling sharply on Oct. 28, stocks rallied and made up for lost ground. In a week light on economic data, quarterly reports took center stage. Profits at ExxonMobil soared 75% to a staggering $9.9 billion as the oil giant benefited from higher energy prices. Meanwhile, net profits at Microsoft and Time Warner rose sharply; both beefed up their stock buyback programs.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	NOV 2	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1214.8	2.0	0.2	7.4
Dow Jones Industrials	10,472.7	1.2	-2.9	4.4
NASDAQ Composite	2144.3	2.1	-1.4	8.0
S&P MidCap 400	712.8	3.2	7.5	18.5
S&P SmallCap 600	345.3	3.2	5.0	16.0
DJ Wilshire 5000	12,144.0	2.1	1.6	9.8
SECTORS				
BusinessWeek 50*	735.2	2.5	4.3	12.4
BW Info Tech 100**	165.5	1.7	-2.1	6.3
S&P/BARRA Growth	579.5	1.4	-0.4	6.1
S&P/BARRA Value	631.1	2.5	0.9	8.7
S&P Energy	374.9	3.2	29.9	37.2
S&P Financials	410.7	2.2	-0.1	6.1
S&P REIT	147.3	1.1	2.0	9.7
S&P Transportation	235.5	3.4	-2.5	5.3
S&P Utilities	157.1	0.7	11.0	19.3
GSTI Internet	190.7	5.1	7.0	22.6
PSE Technology	807.4	1.5	3.6	13.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	NOV. 2	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1432.4	0.9	2.5	14.2
London (FT-SE 100)	5358.6	2.5	11.3	14.[illegible]
Paris (CAC 40)	4429.7	0.4	15.9	17.[illegible]
Frankfurt (DAX)	4954.8	1.1	16.4	22.[illegible]
Tokyo (NIKKEI 225)	13,894.8	3.7	20.9	27.6
Hong Kong (Hang Seng)	14,597.5	1.0	2.6	9.[illegible]
Toronto (S&P/TSX Composite)	10,585.7	2.9	14.5	19.[illegible]
Mexico City (IPC)	15,896.5	1.5	23.1	36.[illegible]

FUNDAMENTALS	NOV. 1	WEEK AGO	YEAR A[illegible]
S&P 500 Dividend Yield	2.00%	2.09%	1.69%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.7	18.1	19.3
S&P 500 P/E Ratio (Next 12 mos.)*	14.3	14.1	15.5
First Call Earnings Surprise*	1.26%	1.60%	2.99%

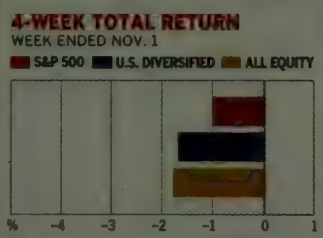
*First Call Co[illegible]

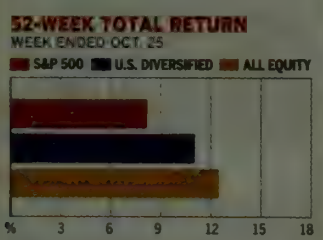
TECHNICAL INDICATORS	NOV. 1	WEEK AGO	READI[illegible]
S&P 500 200-day average	1199.3	1199.1	Positiv[illegible]
Stocks above 200-day average	49.0%	49.0%	Neutra[illegible]
Options: Put/call ratio	0.79	0.82	Positiv[illegible]
Insiders: Vickers NYSE Sell/buy ratio	3.18	3.52	Negativ[illegible]

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Internet Software	12.2	Oil & Gas Refining	109.4
Airlines	10.6	Managed Health Care	76.8
Genl. Merchandise Chains	9.6	Oil & Gas Drilling	61.9
Employment Services	9.3	Oil & Gas Exploration	61.7
Hypermkts. & Superctrs.	9.2	Fertilizers & Ag. Chems.	54.5

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
IT Consulting	-21.8	IT Consulting	-50.[illegible]
Automobiles	-14.7	Automobiles	-35.[illegible]
Building Products	-12.3	Home Furnishings	-27.[illegible]
Power & Energy Traders	-12.0	Photographic Products	-25.[illegible]
Oil & Gas Storage	-11.9	Aluminum	-22.[illegible]

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Financial	2.4	Latin America	57.2
Japan	2.2	Natural Resources	43.8
Large-cap Growth	-0.6	Diversified Emerg. Mkts.	33.1
Large-cap Blend	-1.0	Japan	25.8
LAGGARDS		**LAGGARDS**	
Utilities	-6.7	Domestic Hybrid	6.5
Pacific/Asia ex-Japan	-5.5	Technology	7.9
Diversified Emerg. Mkts.	-5.0	Financial	8.4
Natural Resources	-4.4	Miscellaneous	8.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Berkshire Focus	7.1	iShares MSCI Brazil Idx.	73.8
Merrill Lynch Glbl. Val. B	6.6	T. Rowe Price Lat. Am.	72.9
Japan Smaller Companies	6.3	iShares S&P L. Am. 40 Idx.	72.0
ProFds. USh. Sm. Cap Inv.	5.9	Gartmore Gl. Ntrl. Rscs. A	69.7
LAGGARDS		**LAGGARDS**	
American Heritage Grth.	-20.0	Ameritor Investment	-60.9
Ameritor Investment	-18.2	American Heritage Grth.	-42.9
ProFunds Utilities Inv.	-12.3	ProFds. USh. Mid Cap Inv.	-27.0
U.S. Glbl. Accde. E. Erpn.	-11.8	ProFds. USh. Sm. Cap Inv.	-20.4

INTEREST RATES

KEY RATES	NOV. 2	WEEK AGO	YEAR A[illegible]
Money Market Funds	3.43%	3.36%	1.33%
90-Day Treasury Bills	3.93	3.90	1.98
2-Year Treasury Notes	4.43	4.37	2.57
10-Year Treasury Notes	4.61	4.59	4.05
30-Year Treasury Bonds	4.38	4.79	4.81
30-Year Fixed Mortgage†	6.19	6.12	5.60

†BanxQuote, In[illegible]

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.94%	4.59%
Taxable Equivalent	5.63	6.56
Insured Revenue Bonds	4.03	4.66
Taxable Equivalent	5.76	6.66

THE WEEK AHEAD

INSTALLMENT CREDIT *Monday, Nov. 7, 3 p.m. EST* » Consumers most likely accrued another $5.6 billion in debt during September. That's according to the median forecast of economists polled by Action Economics. Installment credit grew $4.9 billion in August.

INTERNATIONAL TRADE *Thursday, Nov. 10, 8:30 a.m. EST* » The September foreign trade deficit is forecast to have swelled to $60.4 billion. In August the trade gap increased to $59 billion. Higher prices for petroleum products have driven the trade deficit higher, overshadowing some improvement in exports.

EXPORT-IMPORT PRICES *Thursday, Nov. 10, 8:30 a.m. EST* » October export prices most likely grew by 0.4%, following a 0.9% increase in September. Ebbing energy prices probably left the import price index 0.2% higher. In September, import prices jumped by 2.3%.

FEDERAL BUDGET *Thursday, Nov. 10, 2 p.m. EST* » The Federal government probably ran a $58 billion deficit during October, after a $35.8 billion surplus in September. Some downside risk to the forecast exists, given the uncertainty regarding the amount and timing of rebuilding funds paid out to hurricane victims along the Gulf Coast region and Florida.

The *BusinessWeek* production inde[illegible] climbed to 257.9 for the week ende[illegible] Oct. 22 and stood at 12.3% above th[illegible] previous year's reading. Befo[illegible] calculation of the four-week movin[illegible] average, the index hit 261.1.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.[illegible]

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1 1/2 oz Patrón Silver Tequila
1/2 oz Patrón Citrónge Orange Liqueur
1 oz Fresh Lime Juice
1 1/2 oz Cranberry Juice

Add ingredients together
in a shaker with ice.
Shake until well blended
and strain into an ice filled glass,
garnish with a lime wedge.

TEQUILA
PATRÓN

The Companies

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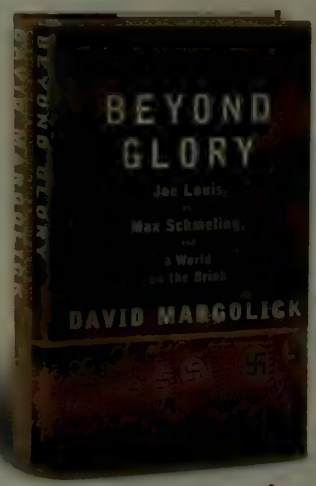
IdeasBooks

Pawns in the Ring

BEYOND GLORY Joe Louis vs. Max Schmeling, and a World on the Brink
By David Margolick; Knopf; 423pp; $26.95

Almost seven decades after the last punch flew, the ring encounters between Joe Louis and Max Schmeling still hold an exalted place in boxing lore, on a par with the heavyweight classics of the modern era: Ali–Frazier I and Ali–Foreman. Unlike those celebrated prize fights, though, the Schmeling-Louis battle of 1936 and the 1938 rematch hold an enduring fascination only partly explained by what went on in the ring. What made those fights matter at the time, and for generations after, were the events unfolding in a world far beyond the ring.



In Nazi Germany, Hitler's hate machine was isolating Jews from the mainstream, stripping them of jobs, wealth, and, when possible, dignity. In fact, after the Nazi takeover, amateur boxing associations were among the first organizations to be purged of Jews. On Mar. 31, 1933, the holder of both the German light-heavyweight and middleweight titles, a Jew named Erich Seelig, was set to defend one of his crowns when Nazis barged into his dressing room and threatened to murder his family unless he fled the country. (He did.)

That is but one of the chilling stories recounted by David Margolick in *Beyond Glory: Joe Louis vs. Max Schmeling, and a World on the Brink*, an illuminating study of the period as well as the match. Schmeling and Louis, their boxing careers forever linked, are hardly a new subject. Their fights—Schmeling's 12-round knockout of Louis in the first meeting and Louis' stunning first-round TKO of Schmeling in rematch—have been picked apart almost ceaselessly since Schmeling hit the canvas on a cool June night at Yankee Stadium.

What Margolick, a contributing editor at *Vanity Fair* and former legal affairs editor at *The New York Times*, adds to the discussion is a meticulous account of how the boxers' lives were buffeted by the political chaos and racial segregation of their age. Just as interesting, he tells how others molded the pugilists' celebrity to promote ideas and agendas—Schmeling represented Nazi Germany's new social order; Louis stood for the aspirations and struggle for justice of U.S. blacks.

Louis and Schmeling embodied the hopes of blacks and Nazis

As Margolick paints him, Lou was a humble, uneducated chil of the Deep Sou who moved to Detroit at age 1 with his mother One of his first paying jobs was at a Ford plant, where he assembled cars even as he took apart amateur opponents in the ring by night.

From his earliest days as a pro, Lou black financial backers aggressively sought to create a public image of him that diverged in every way from Jack Johnson, the only previous black heavyweight boxing champ. Johnson had been the ultimate provocateur—o whose rabble-rousing offered cover to whites who clung to their racial intolerance. By contrast, Margolick writes, Louis was schooled by his handlers to be "soft-spoken, understated, and polite, no matter wh he accomplished."

But Louis' even-tempered persona

made things hard for the storyteller. "When you stripped away all the layers of mythology and idealization, it was hard to say very much about the Louis who remained," Margolick writes. Not that it mattered to his fans, black or white. As the first black hero embraced by American whites, Margolick writes, Louis achieved much in lowering the social barriers between the races.

How did Schmeling regard Adolf Hitler and the Nazi regime that held him up as a symbol of Aryan supremacy? The question is largely unanswered in the book, but it seems clear that his guiding philosophy was self-preservation. Margolick exhaustively recounts the boxer's chummy meetings with Hitler and quotes liberally from the diary of Joseph Goebbels, minister of propaganda, who listened to radio broadcasts of at least one fight with Schmeling's wife at his side.

Then again, Schmeling hardly acted like a true believer in Hitler's cause. For most of his career, his manager was a Jew from New York, Joe Jacobs. And Margolick recounts how, on *Kristallnacht*, the infamous night Jewish homes and stores were ransacked throughout Germany, Schmeling picked up a friend's two Jewish teenage children and hid them for several days in his Berlin hotel suite.

Also missing from the book is any testimony from Schmeling himself. While Louis died at age 66, in 1981, Schmeling passed away just last February, at the age of 99. But in his final years, the author says, he refused to speak to reporters. Too bad for Margolick. For readers, it feels like the old champ slipped one final punch. ■

–By Mark Hyman

The BusinessWeek Best-Seller List

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IdeasViewpoint

BY JEFFREY E. GARTEN

Keep Boomers on the Job

No one can foresee the full impact on American society when the nation's 77 million baby boomers start retiring next year. Serious strains are already surfacing about corporate pensions, and concerns are mounting over the future of Social Security and Medicare. But there is another equally vexing challenge: the need to create more ways for older workers not to retire and instead remain in the labor force longer. They could do this by keeping or modifying their existing jobs or finding other employment. But it won't be easy.

There are many reasons why boomers should be able to prolong their careers, aside from the desire of many to continue leading professionally active lives. Raising the normal retirement age and allowing older workers to continue drawing some benefits from private employers would take pressure off the government-funded social safety net. For those who would otherwise have retired, there is a chance to remain more mentally alert and engaged in their communities. In the past, concerns about the difficulty of the over-60 generation engaging in strenuous labor would have been warranted, but this should be less of a concern in today's service economy.

Moreover, the U.S. can ill afford to lose all these workers right now. Fully 43% of the workforce is eligible to retire in the next 10 years, and the next two generations are each at least 15% smaller. So if boomers retire on schedule, many companies will experience labor shortfalls. The crunch will come in businesses that are already scrambling for skilled employees, such as energy, health care, and education. In Europe and Japan, where younger workers are in even shorter supply, the pressure will be worse. Unless something is done, wages in the worker-starved advanced industrial nations could rise to uncompetitive levels, and more of the world's creation of goods and services will move to the developing world—leading to even more dangerously lopsided imbalances in trade and finance than exist today.

Action is required on three fronts:

■ **CHANGE ATTITUDES** The U.S. and Europe are used to offering early retirement to make way for younger workers, but pending labor shortages negate this problem. In addition, we tend to think about the aging society as a cost borne by younger, tax-paying citizens. For example, in our pay-as-you-go Social Security system, we're continually warned that in the future far fewer workers will be supporting one retiree than is now the case, resulting in sky-high tax burdens. But we should also acknowledge the benefits boomers bring to the economy by dint of a lifetime of acquired skills and practical judgment.

■ **EXPAND CORPORATE EFFORTS** The AARP has formed alliances with companies such as Borders Group and Pitney Bowes to make it easier for older workers to remain on the job or convert their positions to part-time work and to create mentorship programs for younger ones. These alliances also advertise job openings to older workers who are not former employees of the companies. Another example of good practice: Home Depot has launched a campaign to hire people over 60, provides flexible working arrangements for them, and makes their presence part of its corporate image. We need more such efforts.

> Too many retirees create a shortage of workers and a huge strain on the federal safety net

■ **MODERNIZE GOVERNMENT'S APPROACH** Changes in pension and tax law are required so that business can more easily establish phased retirement programs that permit older employees to draw funds from their pension plans while continuing to work. This is nearly impossible under current regulations that prohibit such "double-dipping." Also, modifications are necessary to the Age Discrimination & Employment Act. Right now, many employers would like to create special programs for workers over 60. But under current laws they could be sued for discriminatory treatment. Governors and mayors should also restructure government-funded training programs, now focused on young workers displaced by international trade, to help boomers, too, in preparing for extended careers.

In just a few years the aging workforce in the U.S. and abroad will become a central societal problem. But there's no reason why it can't be turned into an opportunity as well. ■

Jeffrey E. Garten *is Juan Trippe professor at The Yale School of Management (jeffrey.garten@yale.edu).*

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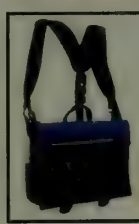

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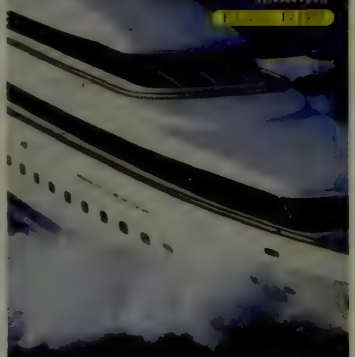

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IdeasOutside Shot

BY DAVID M. WALKER
Comptroller General of the U.S.

Spending Is Out of Control

The Roman Empire fell for many reasons, but three seem particularly relevant for our times: (1) declining moral and ethical values and political comity at home, (2) overconfidence and overextension abroad, and (3) fiscal irresponsibility by the central government. All these are certainly matters of significant concern today. But it is the third area that is the focus of my responsibility and authority as Comptroller General, the nation's top auditor and chief accountability officer.

Unfortunately, there is no question that both U.S. government spending and tax cuts are spiraling out of control. Recent increases in federal budget deficits have far outpaced the cost of the global war on terrorism and incremental homeland security costs. Although the $319 billion fiscal 2005 deficit was considerably lower than the previous year's, it is still imprudently high—especially given that federal spending is expected to increase dramatically when the baby boomers begin to retire later this decade.

Less well known, the federal government's long-term liabilities and net commitments, such as those relating to Social Security and Medicare, have risen from just over $20 trillion in fiscal 2000 to more than $43 trillion in fiscal 2004, in large part because of the passage of the Medicare prescription drug bill in December, 2003. This translates into a burden of more than $150,000 per American and $350,000 per full-time worker, up from $72,000 and $165,000 in 2000, respectively. Those amounts are growing fast because of continuing deficits, our aging society's longer lifespans, slower workforce growth, and compounding interest costs.

The head of the GAO calls for controls on both tax cuts and spending

THAT'S WHY IT'S TIME to get serious about our nation's fiscal future. The federal government should provide more clarity about where we are and where we are headed from a fiscal perspective. It also should reimpose meaningful budget controls on both the tax and spending sides of the ledger and begin a long-overdue review of all major federal spending programs, tax policies, and operating practices. Believe it or not, much of the government is on autopilot and based on economic, security, workforce, and other conditions that existed in the 1950s and 1960s. It is time to rationalize and modernize the mission, programs, policies, and operations of the federal government to reflect the challenges and opportunities of the 21st century.

We also need a set of key national indicators to help assess America's position and progress over time and in relation to other countries. Using outcome-based economic, security, environmental, and social indicators—such as life expectancy, infant mortality, and medical error rates, for example—would help strategic planning, enhance performance and accountability reporting, and facilitate the necessary reengineering of the federal government.

Indeed, without a more disciplined approach to our fiscal challenges, policymakers as a default will tend to resort to across-the-board spending cuts and other sweeping measures. Such actions, even if used year after year and on a large scale, won't come near to closing our fiscal gap and will actually result in perverse incentives in some cases. For example, effective agencies and programs with reasonable budgets would be treated the same as ineffective ones with bloated budgets. Recent increases in the total number and dollar amount of congressional "pet projects" serve to make the jo more difficult. Our fiscal challenge is far too grea to continue such business-as-usual approaches. Instead, the President and Congress need to mak some tough choices in connection with entitlement programs, spending practices, and tax policies to put us on a more prudent path.

It's true that other industrialized countries also face serious long-range fiscal challenges. But that's no excuse to delay getting our house in order. After all, our future economic security, competitive standing, quality of life, and even national security are at stake.

As a student of history and a member of the Sons of the American Revolution, I long have been impressed by the example of George Washington, who was a strong believer in fiscal discipline. In his 1796 farewell address, Washington admonished the nation to avoid "not ungenerously throwing upon posterity the burden which we ourselves ought to bear." Americans today would be wise to heed Washington's timeless wisdom. ■

Comptroller General Walker *has been head of the Government Accountability Office since being appointed by President Clinto in 1998 to a 15-year term.*

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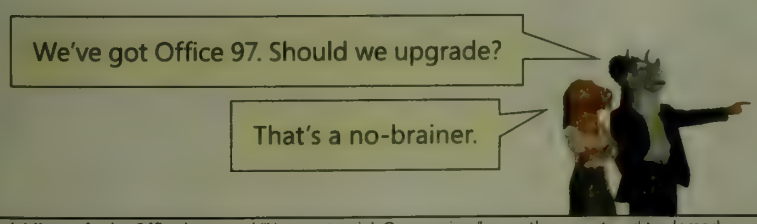

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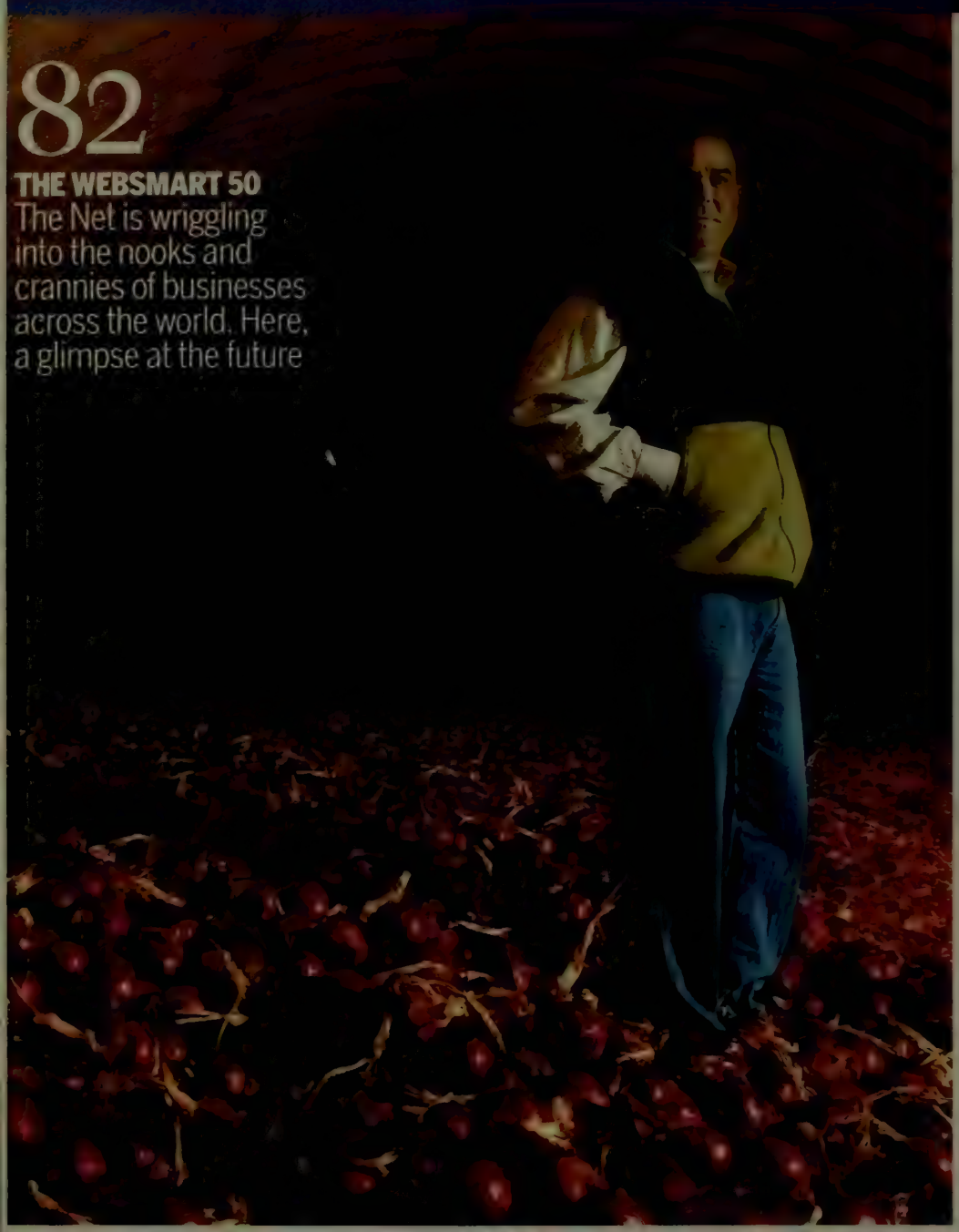

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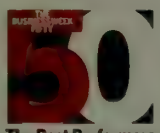

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"HENDRICK'S WON THE GIN CATEGORY"...

- *THE WALL STREET JOURNAL*

THE WALL STREET JOURNAL.

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE*	OUR AWARD
TOP 3 GINS	
Hendrick's $30/750ml	Most Flavorful
Tanqueray No. Ten $26/750ml	Smoothest
Juniper Green Organic $26.50/750ml	Best Presentation

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Now Online, a Gallery That Will Grab You

Visit our newest area: **The Animated Graphics gallery.** Here you'll find a collection of quizzes, graphics, and other interactive features that'll inform you in new ways. For instance, answer eight quick questions to find out if you have **the right stuff to be an entrepreneur.** Also on the subject of startups, we're looking for the best entrepreneurs under 25—and you can help us. View our slide show of candidates, **and cast your vote.** You'll find lots more here as well, so stop in any time and explore

Wal-Mart: A Case for the Defense, Sort Of

A recent academic conclave, sponsored by the retail behemoth, pondered the hot-button question of the moment: Is Wal-Mart good or bad for the U.S.? The verdict: Good, mostly

I Want My HDTV—But Which Flavor?

Sure, high-definition will let you see every detail, down to the hairs on a lion's mane. But you'll need help when it comes to sorting out the bewildering options available today. Here it is

Get the Inside Story on The Web Smart 50

Download a podcast interview with Internet editor Heather Green by Executive Editor John Byrne as they discuss innovative uses of the Web

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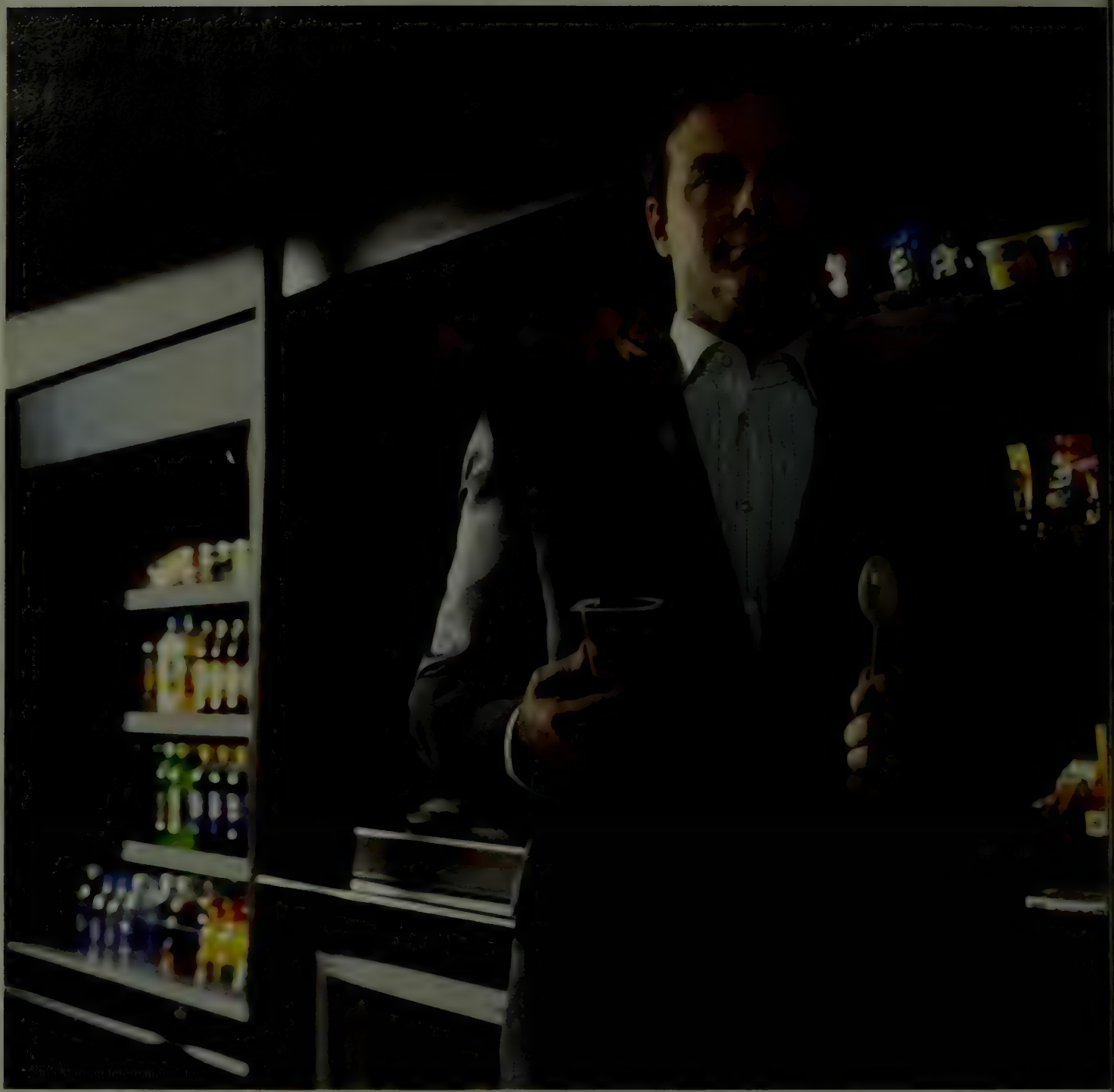

TO SURVIVE IN THIS DOG-EAT-DOG WORLD, SOMETIMES YOU NEED A LITTLE PUDDING

At the end of the day, even the most battle-hardened road warrio
appreciates a cup of sweet, smooth tapioca. Or cool, creamy pistachi
ice cream. Or fresh ham and swiss on a baguette. Whatever busines
travelers' intrepid hearts desire, the new 24-hour markets i
Courtyard's redesigned lobbies have what it takes to satisfy ther

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UP Front

"Just this once, we're going to be like other airlines."

–Independence Air, in an e-mail informing frequent fliers of its bankruptcy filing

EDITED BY DAN BEUCKE

ART OF THE DEAL

GUIDANT AND J&J: DID BEAR GET BURNED?

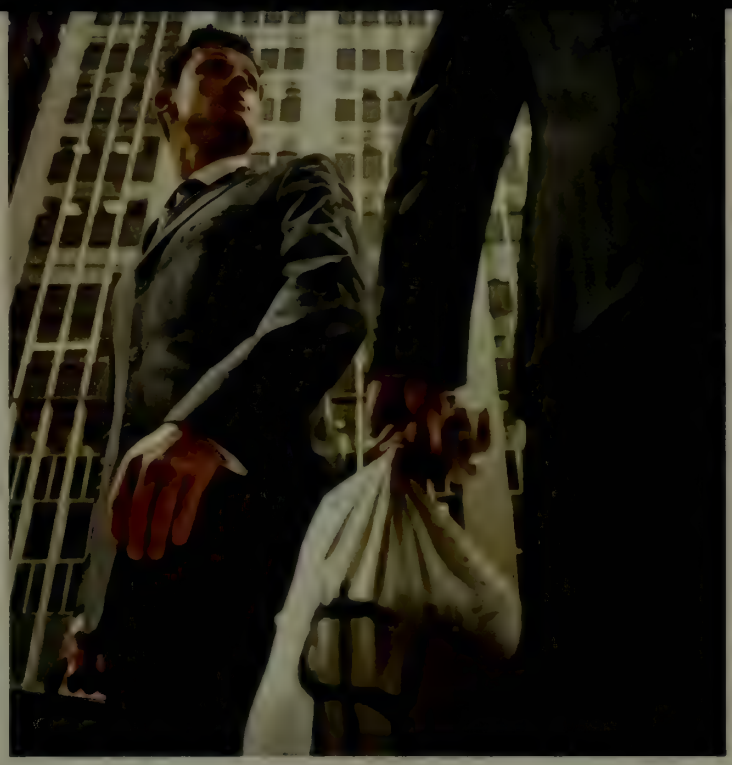
IT'S A WALL STREET mystery: Did **Bear Stearns** take a hit on the imploded **Johnson & Johnson/Guidant** deal? The Wall Street firm has a risk arbitrage desk that makes bets on pending mergers and acquisitions. But unlike many other arb players who keep their positions quiet, Bear Stearns discloses its top five arb bets in a weekly publication to clients, to avoid potential conflicts of interest. On Oct. 17, according to someone who saw that publication, Bear's second-largest arbitrage position was **Guidant.**

On Oct. 18 the deal began to unravel. In a call with analysts, CFO Robert Darretta said J&J was "continuing to consider the alternatives" under the deal—in light of Guidant's recent problems with its defibrillators (below).

Guidant's stock fell 11% that day, to 64.10. A week later the Oct. 24 arb report no longer showed Guidant among the top five positions. Guidant later sued to force J&J to complete the deal, and its stock is now around 56.70.

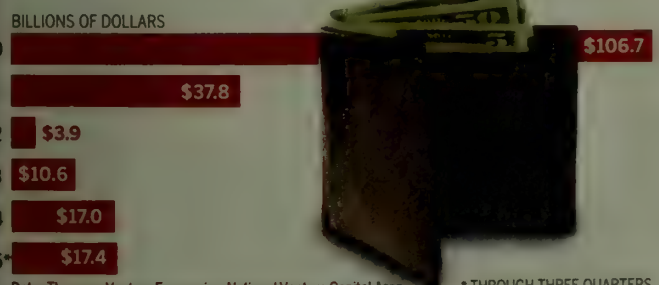
It's possible Bear bought shares earlier this year at prices below 64. Bear won't comment on the record. And if it did lose money, Bear isn't alone. The bigger mystery is: How many others on Wall Street took a hit—and how big? Laments one arb: "Everybody lost."

–Amy Barrett



THE BIG PICTURE

CLIMBING BACK Venture capital fund-raising is still way below its 2000 peak, but it will rise for the third straight year in 2005.



Data: Thomson Venture Economics, National Venture Capital Assn

* THROUGH THREE QUARTERS

BANK NOTES

A Tell-All List For Tellers

IF YOU'VE BEEN A BAD BOY OR GIRL at your bank job, beware. Your name could soon be posted on an industry list of bank employees fired for causing financial loss or compromising customer data. **BITS**, a Washington-based consortium of 100 big banks, is putting the finishing touches on a database due to launch next spring. It could contain the names of scores of ex-employees, who presumably would be banned from working in the industry. Insider-assisted crimes are running amok, say the banks: They lose an estimated $2.2 billion per year to scams ranging from tellers pilfering cash to bankers colluding with identity thieves and credit-card hustlers. "This will serve as a strong deterrent to current employees when they are approached by criminals," says Shirley Inscoe, senior vice-president for loss management at **Wachovia.**

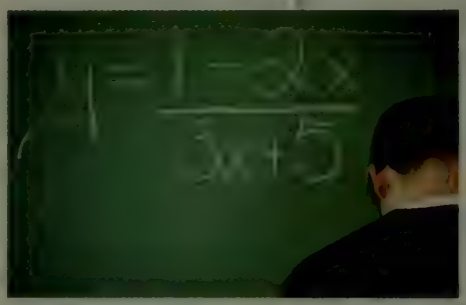
Workers' rights advocates worry that a blacklist could include former workers who were falsely accused or never charged. But banks appear to have legal cover. The USA Patriot Act (page 122) authorizes federally insured banks to disclose information about former employees involved in nefarious doings when they apply for jobs at other banks. *–Brian Grow*

UP Front

CLASS NOTES

JAZZING UP FRESHMAN ALGEBRA

U.S. STUDENTS get off to a strong start in math. But by age 15, they've fallen behind those in 23 other countries. **Raytheon** CEO William Swanson says



that's because many middle schoolers decide math isn't cool. In fact, a survey commissioned by Raytheon found that 84% of kids 11-13 would rather clean their rooms, eat vegetables, or go to the dentist than do math homework.

Raytheon is enlisting these kids to help put more zip into math class. Starting on Nov. 10 they can enter a contest at **mathmovesu.com** by offering ideas on how to make math fun. Winners will get a visit to their school from soccer star Mia Hamm, BMX biker Dave Mirra, or other teen idols. MathMovesU will also offer $1 million in grants and scholarships to teachers, schools, and students with innovative ideas. Raytheon hopes to share the best ideas with math teachers.

The $20 billion defense contractor hires 4,000 engineers a year, so it wants more kids to be math capable. "The numbers are going the wrong way," says Swanson, noting that Europe, Japan, and China do better. For now, Raytheon might be happy if kids chose math over broccoli. *–William Symonds*

STREET PRICES

SHOULD PARKING METERS cost $17 an hour? Donald Shoup thinks that's fine—if the rate drops when demand falls. The University of California at Los Angeles urban planning prof wants to end wasteful trolling for empty meters by charging market prices on smart meters. "It's like Goldilocks," he says. "The price is too low if there are no spaces open, and too high if there are a lot of spaces open." Drivers should pay up at peak times and get a break when demand ebbs, he argues. Chicago, where an hour in a downtown lot can cost $17, is studying the idea. And in February, Redwood City, Calif., will adjust meter rates—every three months—to assure 15% vacancies. *–Joseph Weber*

BLOGSPOTTING

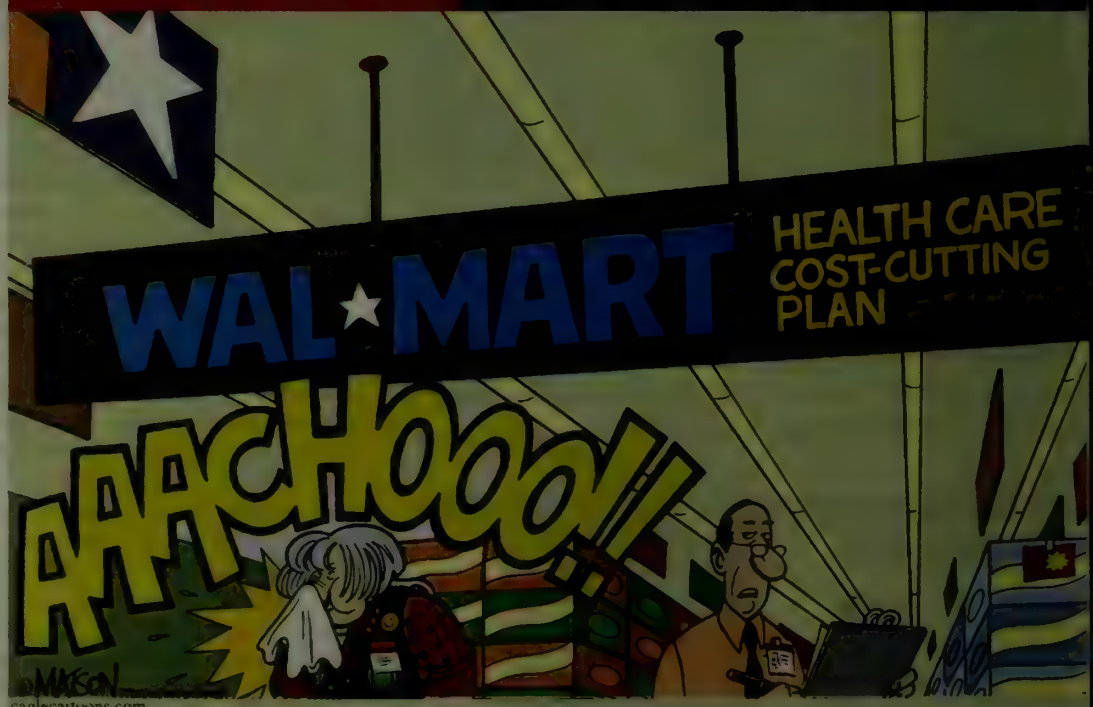
THE EDGE OF THE HEDGE

nakedshorts.typepad.com

» **WHY READ IT:** This blog offers an irreverent take on hedge funds. A one-man show that author **Greg Newton** considers a "self-indulgence," its commentary on scandals and insight on players are followed by industry insiders.

» **NOTABLE POST:** On a report that ousted Refco CEO Phillip Bennett couldn't get co-signers for a $50 million bond: "I must admit that my original reaction was: 'Tough. You can have John Gotti's old space at The Tombs where you can hang out while [former Refco exec] Sandy Maggio makes like Sammy the Bull.'"

DRAWN & QUARTERED



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HEADLINER

RAY OZZIE

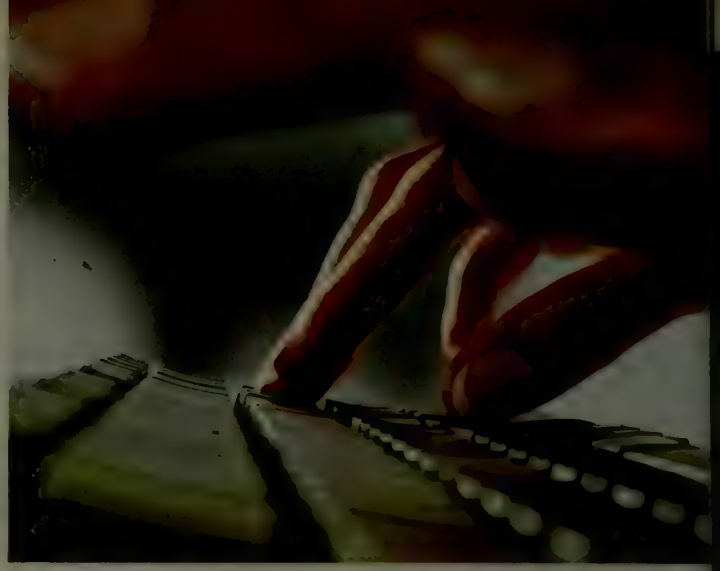
SPELLING IT OUT FOR MICROSOFT

When Microsoft bought Groove Networks in April, it was happy to absorb Groove's software technology into some Office productivity products. But the real key to the deal was Groove founder and CEO Ray Ozzie. Something of a legend in software circles, Ozzie struck digital gold in 1989 when he created Lotus Notes, the widely used messaging software.

Now, Ozzie is pushing the bounds of innovation again. Chairman Bill Gates and CEO Steven Ballmer tapped Ozzie to lead Microsoft's charge into software delivered over the Internet. In a frank Oct. 28 memo to top execs, Ozzie spelled out how Microsoft is trailing rivals such as search leader Google and Net-phone pioneer Skype. "We must reflect upon what's going on around us, and reflect upon our strengths, weaknesses and industry leadership responsibilities, and respond," Ozzie wrote. "It's clear that if we fail to do so, our business as we know it is at risk." Sometimes, it takes an outsider to cut through the fog. *–Jay Greene*

OVER THERE

QUESTIONS? INDIA'S GOT ANSWERS



THE NEXT FRONTIER in outsourcing may be a sort of **Google Answers** on steroids. Launched by ex-**McKinsey** consultants, **PipalAnswers.com** fields business, financial, or marketing questions by e-mail and forwards them to its researchers in India. They quote a price and e-mail back answers in a PowerPoint presentation. The service is an offshoot of **Pipal Research** of New Delhi, the research arm of ICICI, India's second-biggest bank. So far, it has around 10 clients, including **Bear Stearns**.

Sanjeev Arora, a Chicago-based vice-president of Pipal Research, says such piecemeal research fills a niche between inexpensive services such as Google Answers, which rely on online searching, and high-priced consultants like McKinsey or **Bain**. Arora says most of Pipal's 100 Indian researchers have MBAs or master's degrees in finance or accounting. A one-day query costs $300 to $600; a weeklong project, $1,500 to $3,000.

That's 25% to 40% less than in-house or other outsourced research services, says Ravi Aron, assistant professor of operations and information management at **The Wharton School**. He thinks that PipalAnswers.com's model may give it an edge over outsourcing outfits with Indian operations such as **Pangea 3** and **OfficeTiger** that aren't purely transaction driven. In any case, he expects other research firms to jump in and expand into more specialized fields such as the law and biotech. *–Elizabeth Woyke*

MEET THE SPOKES-THINGS

In the scramble to address personal health issues, companies and groups are turning to ever more edgy mascots:

	PROSTY THE SPOKESGLAND	MR. AND MRS. MUCUS	DIGGER
WHAT THE...?	He's supposed to be "an understandably enraged prostate gland"	The goopy couple sets up house in a person's respiratory system	An animated creature who turns toenails yellow, in TV, print, and online ads
WHY?	Chosen in October by the AdMeTech Foundation to promote new treatments for prostate cancer on TV and Web ads	Have helped Adams Respiratory Therapeutics sell their expectorant, Mucinex, since last year	Probably the world's most recognizable dermatophyte, Digger has been flogging Lamisil anti-fungal tablets since 2003
SQUIRM FACTOR	Just the idea of an animated prostate gland	When they are "evicted" through a bronchial passageway	When he lifts up a patient's infected toenail

Data: BusinessWeek

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New Face, New Voices

YOU KNOW MARIA BARTIROMO for her groundbreaking reports from the hectic floor of the New York Stock Exchange and fo her work as host of CNBC's popular *Closing Bell with Maria Bartiromo*. So you also know Maria is a tenacious reporter and a deft interviewer. Her past conversations with the likes of Warren Buffett, Jack Welch, Sandy Weill, and Michael Eisner have made for compelling television. Like us, she also believes in the power of print.

We're delighted that Maria is joining *BusinessWeek* as a regular columnist. Her column, "Face Time with Maria Bartiromo," will run every other week and will deliver interviews with figures of interest and importance. For her debut column, please turn to page 166.

BARTIROMO Her column will appear every other week

IN THIS WIRED and wireless age, with news readily available in real time, many of you have told us that our magazine serves you best when it presents news, information, analysis, and insights that you can't find elsewhere. That's how we strive to fill our pages each week, with the goal of helping you make smarter decisions. Meanwhile, we provide up-to-the-minute reports on business developments each day at BusinessWeek Online. But we know that you sometimes miss key business news in the rush of a week's frenetic schedule. "The Business Week," a two-page feature that also appears for the first time this week (page 38), is designed to fill that gap wi concise, authoritative summaries of the most important business news. These summaries will direct you to related articl in the magazine or at BusinessWeek.com.

IN RECENT WEEKS, you may have noticed a new info graphic called "Playbook: Best-Practice Ideas" accompanying certain articles. It reflec our commitment to help you make better use of *BusinessWeek* by highlighting approaches that seem to working well for companies we write about—and that may be applicable to your business as well.

Let us know what you think. ■

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ReadersReport

> I challenge [Jim Cramer] to participate in his own "Mad Money Challenge" contest to see how he does against the rest of us."
>
> *–Mike Drew*
> *Oakland, Calif.*

)VE HIM, HATE HIM, YOU AN'T IGNORE JIM CRAMER

ENEATH the mad entertainment of Jim amer ("The mad man of Wall Street," over Story, Oct. 31), there is a serious and ise student of stocks. He is remarkably nservative in trying to protect the instments of his audience, most of whom me off as naive cult worshippers. One ust listen very carefully and pause before unging. Cramer is a huge plus among e freebooting pirates of Wall Street.

–Lionel Horwitz
San Francisco

RAMER'S REFRESHING honesty rerding some of his bad stock recomendations (as demonstrated on the Day Atonement, Yom Kippur) gives him a man touch and professional credibility. nd besides, his theatrics and energy liv- up an otherwise dour subject (money). ust hope he does not suffer a heart atck during *Lightning Round*.

–Gerold Voigt
Lincoln, Calif.

OUR ASSERTION that Cramer's "Picks of e Week" are up 7.1% ignores the fact at these recommendations represent ly about 1% of the stocks he gives advice during his program. He has made me disastrous recommendations. If he ally wants to certify his stockpicking bilities, I challenge him to participate in s own "Mad Money Challenge" contest see how he does against the rest of us.

–Mike Drew
Oakland, Calif.

N THE SAME ISSUE of *BusinessWeek*, Beware of seers" (Personal Business lus, Oct. 31) suggests investors should ly on strategies that do not use foresting—or in Cramer's case, no hunches impulses. Securities indexes outperm the experts 80% of the time; the 0% of individual managers who do better do not repeat their stellar performance the following year. You cannot make money forever on Wall Street by attempting merely to outwit the next guy.

–Earl J. Weinreb
Forest Hills, N.Y.

CLEARING THE AIR ABOUT MARLBORO'S MARKETING

"LEADER OF THE PACKS" (Marketing, Oct. 31) provided an accurate depiction of Philip Morris USA Inc.'s efforts to thank Marlboro adult smokers with a variety of programs and events. However, some see buzz marketing as synonymous with "guerrilla" or "stealth" marketing, which may include paying an individual to promote a product without disclosing the employment relationship to prospective consumers.

No aspect of Philip Morris USA's marketing, including our efforts to support the Marlboro brand, has been in the slightest way covert. At all our events, including those in your article, our representatives identify themselves as working on behalf of Philip Morris USA or one of our brands. And all correspondence to those on our age-confirmed adult smoker database is clearly identified as coming from Philip Morris USA or one of our brands.

–Peggy Roberts
Philip Morris USA
Richmond, Va.

WHY THERE'S NO U IN QANTAS

IN "BOEING ROARS Ahead" (News: Analysis & Commentary, Nov. 7), your writers have accurately spelled Qantas Airways. However, the person who designed the chart wasn't as lucky. In 1920, in Outback Australia, an airline was born. It was called Queensland and Northern Territory Aerial Services Ltd. (QANTAS). We pronounce the acronym "Kwontas," but spell it Qantas.

–Michael Abraham
Qantas Airways Regional Headquarters
Los Angeles

CORRECTIONS & CLARIFICATIONS

In the story "Dear Abby, What happened?" (News: Analysis & Commentary, Nov. 14) about Abigail Johnson of Fidelity Investments, we reported that Johnson confirmed to *BusinessWeek* that she fought with her father, Chairman and CEO Edward C. Johnson III, about an extensive overhaul of the firm's mutual-fund business. Abigail Johnson ran the unit until May, when she was moved to a different position. In fact, we relied not on interviews with either Johnson, but rather on prepared statements that Fidelity sent us in answer to our questions. In one, Edward Johnson said: "...the founder of Fidelity encouraged a constant interplay of ideas between the generations of Johnsons...a back-and-forth of arguments, often including spirited differences of opinion, but ultimately leading to the growth of Fidelity. That same belief in constructive debate exists today." A quote provided from Abigail Johnson said: "I wholeheartedly agree with what my father said: Our family will continue to work together closely to ensure that the things that have made Fidelity a great company over the years continue far into the future." These quotes do not support the conclusion we drew from them. Further, we should have made clear that they were provided by the company and not the result of interviews. We regret these errors in judgment and the departure from our journalistic standards.

"Rivals are eyeing Wyeth" (Inside Wall Street, Nov. 14) should have said that David Moskowitz of Friedman, Billings, Ramsey rates Wyeth "outperform," not Andrew Forman, as incorrectly mentioned.

"Debt collection puts on a suit" (Finance, Nov. 14) should have said that Asset Acceptance Capital Corp. is the largest listed company in the sector by market cap. NCO Group Inc. is larger by sales.

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Technology&You

BY STEPHEN H. WILDSTROM

The Juicy New BlackBerry

Everyone these days seems to be drawing a bead on Research In Motion (RIM), the maker of the BlackBerry. Microsoft officials say they are readying new software for server computers that will turn Pocket PCs into "BlackBerry killers." Companies from phone giant Nokia to startup Sproqi Technologies offer competing services that forward e-mail and other data t

handhelds. And it's not just enemy products that threaten RIM: There's a remote possibility that a long-running patent dispute could lead to a court-ordered halt of U.S. BlackBerry sales.

Notwithstanding such challenges, RIM, based in Waterloo, Ont., has been enjoying robust sales and earnings—all the while pouring its resources into products and services that could preserve its edge. Its newest device, the BlackBerry 8700c, costs $299 with a two-year contract from Cingular Wireless. Versions from other carriers should arrive in the coming months.

The 8700c is a distinct improvement over previous models. The first thing you notice is that it's almost handsome compared with the utilitarian homeliness of the "BlueBerry" 7290 it replaces. The silver-and-black case is a critical quarter-inch or so narrower, so you can operate it with one hand. Like the smaller 7100 series introduced last fall, the 8700 is far more phone-like than previous BlackBerrys, with proper red and green Send and End buttons and a phone-style 10-key dial pad highlighted in the keyboard.

Unlike the 7100, which compromised the keyboard to allow for a much narrower design, the latest keyboard redesign is a step up. The overall size is a bit smaller, but the individual keys are larger and closer together. The key rows are arranged in a sort of Mona Lisa-smile curve, a design similar to the Palm Treo 650.

THE DISPLAY IS THE MOST STRIKING new feature. The screen, with twice the resolution of the earlier model, is still smaller than those of the Pocket PC or the Treo, but it finally matches them for brightness and vivid color. The menus and screen layouts are largely unchanged, but I found the new BlackBerry easier to use—perhaps because of the improved display and icons that make better sense.

Under the hood, the 8700 is completely redesigned around the same type of Intel XScale processor used in Treos and Pocket PCs. This makes the new BlackBerry's performance a lot snappier. It also should placate software developers writing custom applications for the BlackBerry,

THE 8700c It's easier to dial, and the network is fast

who have long bemoaned its lack of processing power. Thanks to a boost in horsepower, the use of Cingular's relatively fast EDGE network, and a new browser, t BlackBerry has gone from bei the worst PDA for Web surfing to perhaps the best. Data load quickly, and even complex pag are reformatted to be readable on the small screen. But you d pay a price in battery life for performance. On one charge, the new BlackBerry lasted a d and a half with heavy mail use about the same as the adequat but not great, Treo 650.

The one aspect of the BlackBerry that remains unchanged is its outstanding ability to retrieve mail, either from a desktop mail account or directly from a corporate mail server. The corporate version that I used syncs mail, contacts, and calendar flawlessly over the air, although I fou the handheld applications are still a bit clunkier than a Treo running the similar GoodLink service from Good Technolog

RIM is also moving beyond BlackBerry hardware to meet the competition. BlackBerry Connect software, which lets BlackBerry service run on other devices, has been available Europe and Asia for some time. The software will appear in the U.S. when Cingular offers the Nokia 9300 Communicat this fall and, more important, when Verizon Wireless ships the Windows Mobile-based Treo 700 early next year. BlackBerry aims to remain the king of mobile e-mail, and RIM seems to be making the right moves to stay on top. ■

E-mail: techandyou@businessweek.c

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Where Ridder Went Wrong

Media inkblot of the moment: Knight Ridder and its angry shareholders. Those who dream of kinder, gentler newspaper ownership fantasize about deep-pocketed locals. (A certain mogul has reportedly inquired about the *Los Angeles Times*, so call this the "David Geffen scenario.") Those who live to ponder balance sheets envision slashed costs and the remaking of the

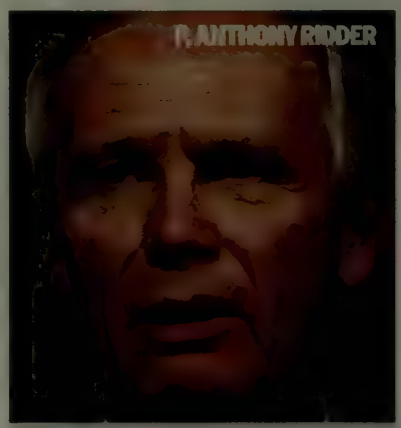
U.S. newspaper industry. (A key Knight Ridder editor was literally sickened by the last round of staffing cuts, so call this the "Making the Editors Vomit scenario.")

Soon all may be clear: Deutsche Bank analyst Paul Ginocchio sees a 75% chance that Knight Ridder, the second-largest U.S. newspaper company, will be sold within a year. (At press time no other institutional shareholders had joined the three major investors—which together hold around 35% of the stock—in public demands for a sale or strategic change.) The Street sees no obvious single buyer among its peers or private equity. But a reasonable scenario can be conjured wherein Knight Ridder's 32 daily papers are split among several parties, including privately held newspaper operator MediaNews Group and publicly traded Gannett—these two teamed up to take the *Detroit Free Press* off Knight Ridder's hands in August—and McClatchy, with some spillover going to private equity.

This would mark a weird and ignominious end to Knight Ridder—and the career of P. Anthony Ridder, the 65-year-old family scion who has been chairman and CEO for a decade. But during his tenure, through circumstance and choice, Knight Ridder solidified a portfolio that left them exposed to what could be called the curse of the cities and the stigma of the second tier. (A Knight Ridder spokesman declined to comment.)

In the mid- to late '90s, when national advertising was growing by double digits, big city dailies soaked up torrents of dollars. In 2005, though, national ad growth is down to droplets, and big city players are seeing plunging circulation and increased competition, largely from Craigslist and free dailies. *Metro*, Sweden's free-paper chain, first launched in the U.S. in Philadelphia and Boston. These cities' paid dailies have since become notoriously weak performers.

Knight Ridder owns dailies in many major metro markets—including, alas, Philadelphia—but its footprint is tentative. It has no dailies in the top three markets. In key metro centers Minneapolis and Dallas, it's in St. Paul and Fort Worth. (Ditto San Francisco, where it owns the *San Jose Mercury News*.) This doesn't help pry dollars from national ad accounts. Historically Knight Ridder's reputation was for quality papers, but years of severe cuts left them nowhere near *The Washington Post* or *The New York Times*, both of which boast quality halos that can drive future ancillary businesses and value. And despite recent ax-wielding, Knight Ridder hasn't matched industry peers in cost-slashing. Its margins still trail Gannett's and Tribune's, according to Deutsche Bank. Hence Knight Ridder's twin curses: It's exposed to the downside of cities but not the upside, and it's short on quality yet shy of sufficient stinginess.



75%

The chance Wall Street analyst Paul Ginocchio gives that Knight Ridder will be sold within a year

This might not be a problem if Knight Ridder had non-newspaper assets. It doesn't. It sold off its database unit, Dialog, in 1997. (Today such outfits are in vogue: Consumers pay top dollar for the content, and being ad-free cuts cyclicality.) Knight Ridder sold Dialog after betting bigger on large market dailies via its $1.7 billion deal in '97 to buy four papers from Walt Disney.

Those decisions set today's table. Indeed, Knight Ridder has few options: Fire even more employees? Pay exorbitant multiples to diversify into radio or TV? Admit defeat by leveraging up to buy back stock? Few newspaper execs or even industry analysts have much bad to say about Tony Ridder's tenure. The stock held up well until recently, they say, and Ridder did as well as can be expected given the cards he was dealt. But Ridder and his team weren't just dealt these cards. In many cases they chose them. Now the cards are playing them. ■

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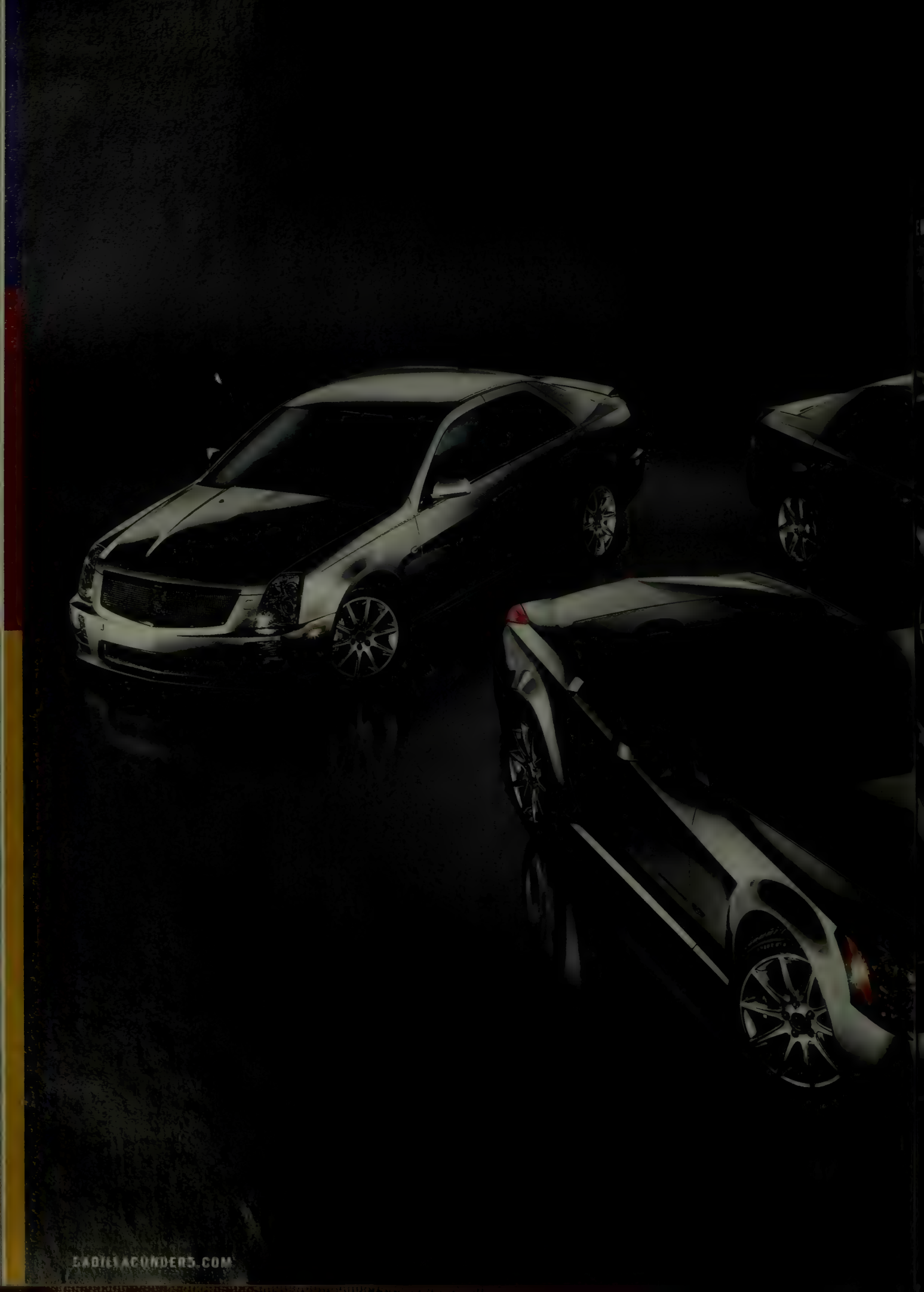
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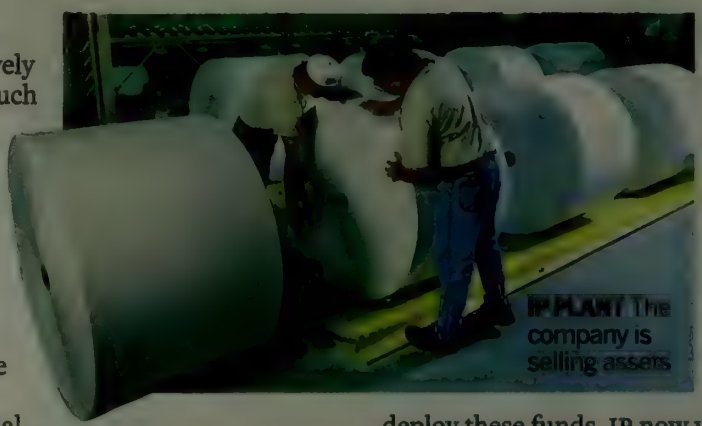
TheBarkerPortfolio

BY ROBERT BARKER

A Promising Paper Route

Worse even than holding newspaper stocks this year has been owning shares in the companies that supply the paper. Bowater is off 35%, Abitibi-Consolidated 50%. It's not just weaker demand for newsprint. Papermakers as a group are down more than 18% this year, as higher energy costs rip into profit margins.

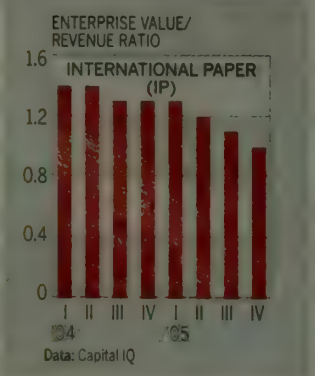
Which got me wondering: Is there a paper stock worth buying now? I confess, this was a reflexively contrarian impulse, given that much of Wall Street sees demand for paper, cardboard, and cartons as near the top of a cyclical peak and nowhere yet near a trough. Depending on the global economy's course, that could be so. But for investors with more than the two or three quarters' worth of patience common on the Street, shares of the industry's single-biggest player, International Paper, may prove unusually rewarding. From more than 42 early this year, the stock lately trades near 29 after dipping below 27, where it caught my eye.



IP PLANT The company is selling assets

AT FIRST GLANCE, EVEN THAT HARDLY appears cheap—23 times the $1.18 a share that IP will earn next year in the Street's consensus view, according to Reuters Fundamentals. But IP has just begun a vast corporate makeover that renders near-term forecasts of small use. Today, IP is a sprawling mass, with operations in uncoated paper (such as what you have in your computer printer), plus cardboard boxes, lumber, plywood, chemicals, beverage containers, and the highly processed coated papers used by the likes of magazine and catalog publishers. All that, plus vast tracts of timber. Within two years, however, IP expects to have shed assets generating 30% of the $25.6 billion in 2004 revenue. Even if it's smaller, by focusing in the future only on two businesses where it has compelling advantages in scale and costs—uncoated paper and packaging—IP expects to enjoy better returns on its assets.

BARGAIN?



In the process, IP expects to raise some $8 billion to $10 billion via sales of assets, notably those 6.8 million acres of forestlands. With timber today taking a growing share of institutional investors' portfolios, demand for acreage and the prices it fetches are high. Some, perhaps 20%, of the proceeds will be plowed back into paper and packaging operations. Most, however, is earmarked to benefit investors. For starters, up to 50% is being directed toward strengthening the company's balance sheet by paying off debt. IP in September got a start on lowering its burden by some $500 million after selling its majority interest in a New Zealand paper producer. Another 30% or so of the proceeds is supposed to be returned to shareholders, via share repurchases, special dividends, and, if sustainable, a higher quarterly payout. To date, IP is being coy about exactly how and when it will deploy these funds. IP now yields 3.4%.

IP's maneuvering won't be limited simply to shuffling assets and liabilities on the balance sheet. It also is at work on operations, closing some paper and packaging plants while reconfiguring others for more profitable uses. How much of IP's 80,000-person payroll will be cut is not known. These changes, plus a move of the company's headquarters from Stamford (Conn.) to Memphis, where it already employs some 3,000 people, promise to lower annual costs an average of $400 million. In all, IP estimates 2007 earnings per share will be 30% more than they would have been without embarking on its transformation. Meantime, if IP's costs for raw materials moderate even by a little bit, then the effect on the bottom line should be dramatic. This year, had energy and other input costs run flat vs. 2004 levels, earnings per share through September would have been 60% higher. As it was, they rose to 96¢, vs. 84¢ in 2004, on a 4% rise in revenue.

It's doubtful IP will run through such a full restructuring without a stumble or two. But much of the risk appears to have been beaten out of the stock. Its enterprise value—that is, market capitalization plus net debt—now comes to just one times annual revenues, a multiple that's down sharply from last year (chart). In any case, IP already is one big step ahead of its rivals: It doesn't make newsprint. ■

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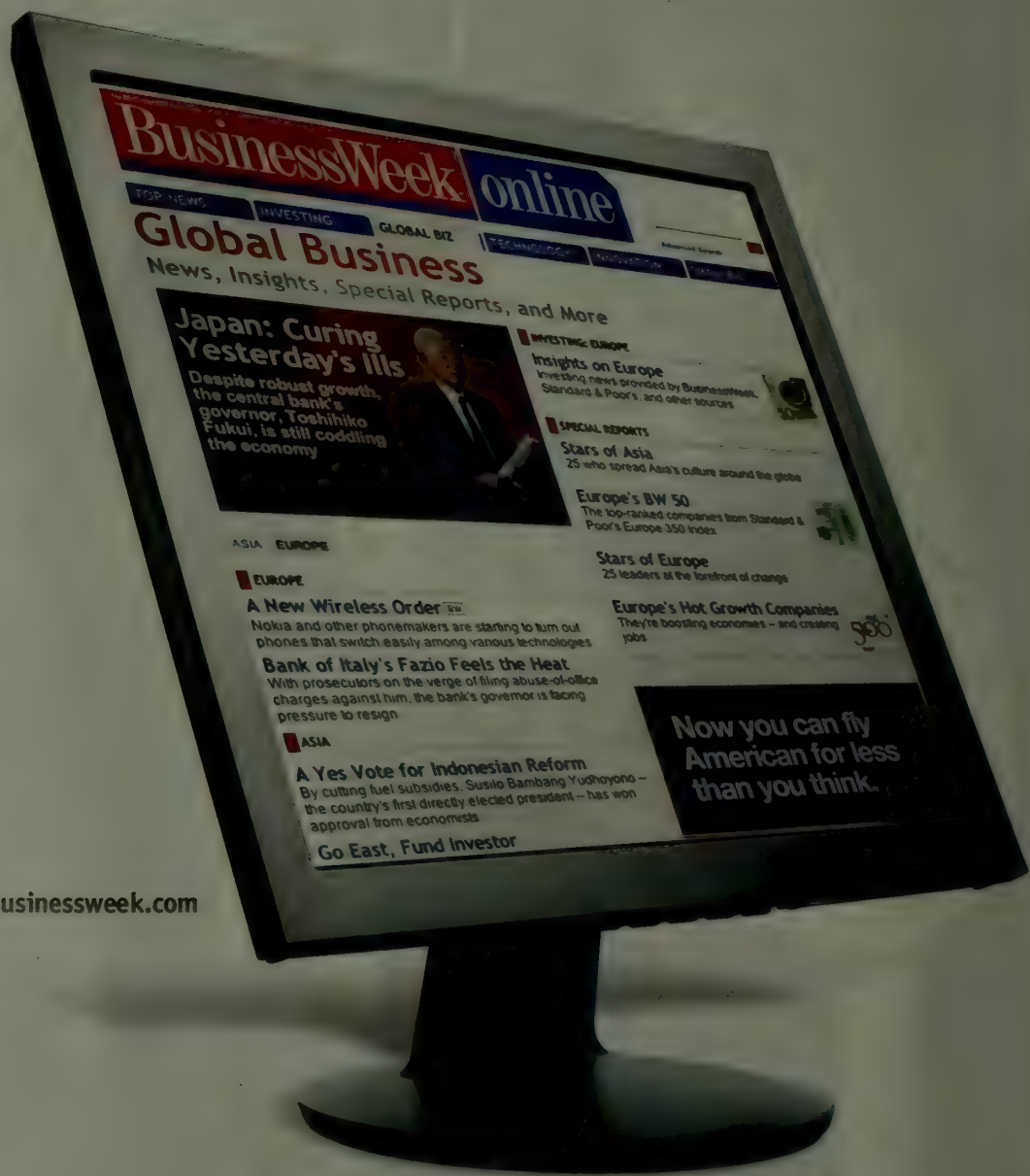

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:Y JAMES C. COOPER & KATHLEEN MADIGAN

Consumers Will Sweat This Stress Test—but Pass

Vith jobs likely to rebound, pricey fuel and rising rates won't feel so bad

U.S. ECONOMY Stronger job markets during the past two years go a ong way in explaining why American consumers have held up so well ınder the burden of costlier energy. That's why the Labor Dept.'s)ctober employment report, which showed a surprisingly weak 56,000 increase in payrolls, raises serious questions about consumers'

bility to keep powering the economy ahead into 2006.

So is this four-year business upswing in any danger? ased on a full reading of the available data, it is way too arly to assume the worst for either the labor markets or onsumers. Other labor market indicators suggest that ıe October softness in payrolls will prove temporary. lso, gasoline prices are down sharply from their post-urricane peaks. Chain-store retailers reported brisk uying activity in October. Capital-goods orders, output, nd employment are growing strongly, suggesting that usinesses remain eager to expand their operations. And ıe manufacturing sector is especially lively.

To be sure, consumers will get a stress test over the ext few quarters, and their contribution to overall rowth in 2006 will most likely slip a notch. On the heels f Hurricane Katrina and sky-high gasoline prices come vinter fuel bills, higher mortgage rates and borrowing osts, and a likely slowdown in home prices that will urtail the flow of cash from refinancing activity. All of his has slammed household confidence, and consumer pending in this quarter will look shaky compared with he solid 3.9% advance in third-quarter outlays.

However, the economy will be getting plenty of oomph his quarter and next from sources other than consumers, ncluding hurricane rebuilding, business investment in quipment, and efforts by companies to rebuild depleted nventories. With other sectors taking up the slack, verall growth will most likely remain strong enough to keep generating jobs and incomes for households.

ONE UNSETTLING ASPECT of the October jobs report vas the comment by Labor Dept. officials noting that the neager payroll gains were broadly based across the U.S., uggesting that direct hurricane effects were not to blame or the weakness. Labor also revised August payrolls, allied before the hurricanes, down sharply.

Nevertheless, the October job data are at odds with ther key labor market indicators. In particular, claims or unemployment insurance show no evidence of any ıew weakening in the job markets (chart). New filings ıave subsided notably since the hurricanes, and xcluding claimant activity in the hurricane-affected reas, claims are running below their pre-hurricane levels. In coming weeks, if claims stay low, then payroll gains should rebound in November and December.

Another sign that the October payroll weakness will be temporary is that much of the softness was in service industries that were most likely to feel some of the indirect effects of the storms and the related surge in gas prices. For example, payrolls of department stores, auto dealers, hotels, and restaurants dropped by 45,000 workers. Those industries make up only about 11% of total employment.

JOBLESS CLAIMS: BACK TO PRE-KATRINA LOWS

Data: Labor Dept., Global Insight Inc.

Contrary to the results of the Labor Dept.'s survey of business payrolls, its separate survey of households showed a strong 214,000 rise in new jobs last month, and a downward tick in the unemployment rate, from 5.1% to 5%. Plus, the household survey did, in fact, show some possible direct hurricane impacts. The number of workers saying they were not at work in October due to bad weather stood at 135,000. That's down from September, but it was still the most in any October in the data's 29-year history.

ONE OF THE MOST encouraging signs that businesses will stay in a hiring mood in coming months is the ongoing strength in capital-goods industries. In the past, trends in business outlays for new equipment and job growth have been tightly correlated.

Capital-goods orders during the third quarter rose above their second-quarter average, and the backlog of unfilled orders through September continues to swell. Also, hours worked in October in the machinery and electronics sectors rose strongly, suggesting big gains in October equipment output. And that's not to mention the return of aircraft production after the Boeing Co. strike.

Companies are also starting to beef up their inventories. Businesses have run very cautious inventory policies this year, reflecting energy-related uncertainties

over demand. So cautious, in fact, that over the past two quarters businesses have actually liquidated stockpiles. That hasn't happened since the 2001 recession, and the pattern is highly unusual in an economy in which overall demand has grown 4.2% during the past year.

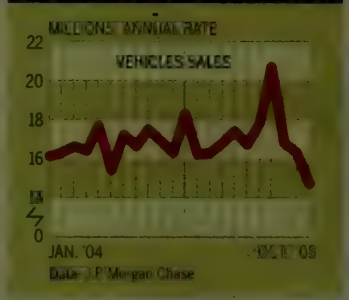
As a result, the ratio of inventories to sales in manufacturing, wholesale, and retail industries has fallen well below its long-term trend, suggesting that inventory levels are too low. Companies surveyed in October by the Institute for Supply Management confirm that. Efforts to rebuild stockpiles, especially as the holiday and post-holiday shopping seasons approach, will be another spur to output and employment in coming months.

CLEARLY, HIGHER ENERGY PRICES have been a drag on consumer spending, but the biggest downdraft that will affect fourth-quarter spending is the drop-off in car buying, reflecting the sag in sales following the highly successful "employee discount" program. That promotion had boosted July sales to a 20.7 million annual rate, the third-highest monthly total on record. After the program ended, October sales skidded to only a 14.7 million annual rate (chart).

That decline, by itself, has put fourth-quarter consumer spending into a deep hole. Fourth-quarter outlays are starting out far below the third-quarter average, a gap that even moderate monthly gains in November and December may not be able to make up. From July to October, real consumer spending appears to have fallen at the fastest annual rate since the 1990-91 recession. That means real outlays for the quarter will be unlikely to show any growth at all from the third quarter.

However, the monthly pattern of sales through the quarter should look encouraging for spending in the first quarter of 2006. Not only did October chain-store sales post a solid 4.4% increase from a year ago, says the International Council of Shopping Centers, but Visa U.S.A. reports that spending by consumers and businesses in the first week in November using Visa-branded payment cards rose 14.7% from a year ago.

THE BIGGEST DRAG ON SPENDING THIS QUARTER



Other pluses in the consumer outlook: The job report showed that hourly pay picked up last month, lifting the annual rate of growth over the past half-year to 3.4%, the best such showing in two years. And those paychecks will stretch further, given the 23% drop in gas prices since their peak in early September. That decline has restored half of the purchasing power robbed by the run-up in gas prices from early June to early September. Also, Detroit has slapped on a new round of sales promotions, and homeowners are still taking cash out of their home value (see box below). Add it all up, and the holiday shopping season may not be the bust that many had feared. ■

HOUSING

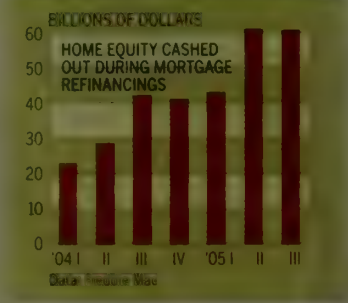
There's Still Plenty of Cash Under That Roof

THE ERA OF using one's home as a piggy bank may not be finished yet. And that improves the economic outlook this winter.

According to the latest data from mortgage broker Freddie Mac, borrowers took $60.4 billion in cash out of their homes when they refinanced in the third quarter. That's on par with the $60.7 billion cashed out in the second quarter and well above expectations.

Homeowners are shifting away from using home-equity loans and instead are refinancing to tap into their homes' wealth. The reason is simple: Because the Federal Reserve has been hiking short-term interest rates, the prime rate, the basis for most home-equity loans, rose to 6.75% last quarter, while a 30-year fixed mortgage rate averaged 5.76%, says Freddie Mac. No wonder home-equity loans were fairly flat this summer while refi activity soared in June and July.

HOME $WEET HOME—STILL A PIGGY BANK



The importance of cash-outs to the economy lies in the fact that the money has fueled a sizable share of demand so far in this upturn. Past Fed studies show that about one-quarter to one-third of cash-outs is spent on current consumption. That explains why consumer spending last quarter jumped by $163 billion, even though aftertax income was up only $61.6 billion. The spending financed by cash-outs contributed 0.7 to 0.9 percentage points of the 3.8% annual rate of economic growth last quarter. By comparison, even with the housing boom still going on, residential construction added only 0.28 percentage points.

Freddie Mac projects that cash-outs for all of 2005 will total $204 billion this year, and slow to $114.5 billion in 2006. That's up from earlier estimates of $162 billion for 2005 and $69 billion in 2006.

To be sure, the negative turn in the bond market in recent weeks has pushed up mortgage rates quickly. The average rate on a 30-year fixed loan hit 6.31% in early November, from 5.71% two months earlier. Not surprisingly, refi activity has been cooling off since September. But the latest mortgage data suggest that consumers are sitting on a lot of cash. That means higher heating oil bills may not crimp consumer spending in the first and fourth quarters by as much as many analysts expect ■

We want you to know

The Importance of Information

There's a better way to get health care information.

People look to a number of sources to help them make their health care choices. Some are better than others. At Aetna, we provide our members with the information they need to make better decisions. And that can help make your workforce healthier and more productive. Make a smart decision now and ask your broker about Aetna insurance plans, or visit us at aetna.com.

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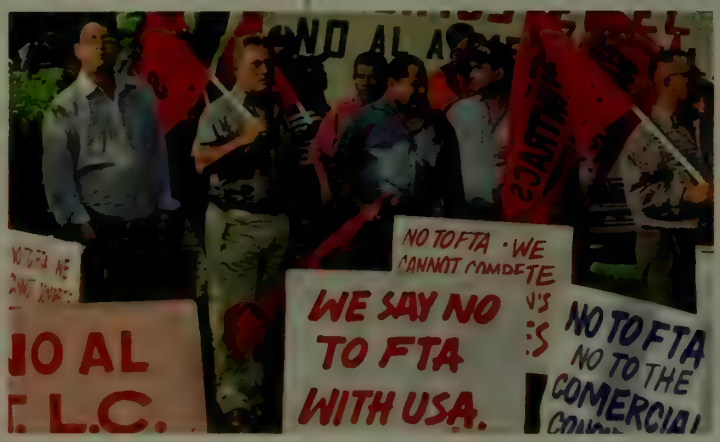
The Business Week

News you need to know

EDITED BY HARRY MAURER



Where Trade Winds Are Blowing It was a busy week for bargainers. In Mar del Plata, Argentina, at the Nov. 4-5 Summit of the Americas (photo of protestors above), most of the region's largest economies cold-shouldered the **Free Trade Area of the Americas,** an idea first proposed 11 years ago. Their main beef: the U.S. refusal to eliminate farm subsidies and barriers to agricultural products. The pact is probably dead for now. But on Nov. 8, Washington and Beijing wrapped up a deal that will limit growth of cheap Chinese textile imports. That helps **George W. Bush** pay a big debt he owes a half-dozen GOP House members from the textile belt who enraged their constituents last July by giving the President the votes he needed to pass the Central America Free Trade Agreement.

Meanwhile, negotiators gathered in London and Geneva in a bid to unsnarl the Doha Round of **World Trade Organization** talks before the Dec. 13-18 meeting of all 148 members in Hong Kong. With rich nations leery of cutting ag subsidies deeply, and poor nations insisting they will make no further concessions on opening their economies until they get the farm deal they want, the trade mavens on Nov. 8 conceded that they were hopelessly stumped and couldn't even agree on an agenda for Hong Kong.

See Washington Outlook, page 55

Wall Street, Fat City There's nothing Street professionals value more than, well, money. So this year their holiday seasons should be happy since many will get bigger bonuses. On average, managing directors will take home $1.2 million in bonuses, up from $1.05 million last yea estimates compensation consultant Johnson Associates Commodities traders could ride roaring markets to bonus es 30% higher than last year, says consultant Option Group. All hail, merger mania: Investment bankers ma get pleasant hikes of 20% more, as will advisers to rapidl multiplying hedge funds. Pity poor stock and bond traders whose bonuses will stay flat—or rise perhaps 5%. Still what more can they expect given that the markets hav gone nowhere?

Cracks in Housing They say nobody rings a bell at th top of a market, but luxury homebuilder **Toll Brothers** cam close on Nov. 8 when it warned investors of "some soften ing of demand in a number of markets" and said that "i appears we may be entering a period of more moderat home price increases." The statement knocked down shar prices across the sector, which was already on edge be cause of higher mortgage rates. Over the past year the av erage 30-year fixed-rate home loan has risen to about 6.3% from 5.7%. Economist Ian Shepherdson of High-Frequen cy Economics in Valhalla, N.Y., argues that a jump t around 7% could cause a "meltdown."

See "Housing: Red alert," www.businessweek.com/go/tbv

Guidant Goes After J&J Suing your former fiancé t drag him back to the altar may not seem like the smartes way to contract marriage—unless you're marrying for mon ey. Jilted at the church door, Guidant took **Johnson & Johnso** to federal court on Nov. 7 to force it to complete its $25.4 bil lion takeover at the $76-a-share price they settled on las December. But Guidant may be better off looking for a nev beau. J&J broke off its original deal contending that Guid ant's recalls of defective pacemakers and defibrillators ha made the Indianapolis company much less desirable. Guid ant has said it'll bounce back soon. Its third-quarter report revealing a 57% plunge in earnings as well as an investiga tion by 34 state attorneys general, showed why J&J got col feet. Guidant stock has wasted away by 10% since Nov. 2.

Here Comes TV 2.0 Signs of the new zeitgeist: Withir several hours on Nov. 7, **TiVo** and **Yahoo!** launched a servic allowing TiVo users to program their digital vide recorders remotely using Yahoo's TV info Web sites; **NBC Universal** announced a new video-on-demand deal with **DirecTV;** and **Comcast** said it would offer **CBS's** hit prime-time shows on demand just hours after they air, some fo 99¢ a pop. Ready for all Channel You, all the time?

See "The end of TV (as you know it)," page 4

That Slippery Oil Patch While the CEOs of **Big Oil** were being hauled before the Senate on Nov. 9 to explain why energy costs so much, the news outside the Beltway wasn' rising prices but falling ones. A gallon of regular gas has slid nearly 70¢ from its average high of $3.07 a gallo just after Hurricane Katrina, reaching $2.38 on Nov. 7. In the futures market, wholesale natural gas and heating oi are down nearly 20% from their Katrina highs. Behind

ne slippage? The same market forces that appeared so nysterious to questioners on Capitol Hill. High prices purred conservation while giving the industry a power-ıl profit motive to import more gasoline and restart re-neries in a hurry.

See "Why energy prices are losing steam," www.businessweek.com/go/tbw

Microsoft's Irish Eyes Want to slice your corporate tax-s by, say, a few hundred million a year? Think Ireland. That's what Microsoft and other tech titans such as **Google** nd **Oracle** are doing, reported *The Wall Street Journal* on Nov. 7. The combination of friendly laws and a skilled vorkforce allows Bill Gates & Co. to transfer intellectual roperty to an Irish unit, **Round Island One,** that rang up 9 billion in profits last year, mostly on licensing fees, argely shielding that income from EU or U.S. tax collec-ors. The Internal Revenue Service is giving such arrange-hents the gimlet eye, but the Redmond (Wash.) company ays it complies with all tax statutes.

Unrest in France Along with cars and buildings, what's oing up in smoke in hundreds of French cities and towns is Europe's welfare state economic model. The violence, which ed **Prime Minister Dominique de Villepin** to impose a state of mergency on Nov. 8, certainly flares from the second-class itizenship to which millions of immigrants, mostly North African Muslims, have long been condemned. But it also has roots in a society that tolerates slow growth and astonishing levels of unemployment—21.7% of 15-to-24-year-olds in September—in return for a comfy, costly social safety net and job protections. France now faces a choice between real reform, palliative moves, and a repressive backlash. Its EU neighbors, many suffering similar stagnation, are watching nervously to see how far the fires spread.

See "The economics fueling the French riots" and "France burns for its sins," www.businessweek.com/go/tbw

Malone Gets His Man In **John Malone**'s world, the deal s king. Little wonder then that he recruited outgoing Ora-cle co-chief **Gregory Maffei,** once a dealmaking CFO at **Microsoft**, as CEO of **Liberty Media**. Malone has been maneu-vering for months, spinning off foreign cable holdings and a 50% stake in the **Discovery Channel** into separately traded companies. The 45 year-old Maffei will help create a new tracking stock for Liberty's holdings in TV-shopping com-pany **QVC,** travel site Expedia, and **Barry Diller's** online re-tailer **IAC**. But more deals are coming. Malone wants to buy pieces of other online retailers. Maffei's big score would be to help Malone swap assets with **Rupert Murdoch's News Corp.,** in which Liberty holds an 18% stake. For that, Mal-one could use all the dealmaking mojo he can muster.

See "Gregory Maffei's marching orders," www.businessweek.com/go/tbw

Grokster Logs Off Score one for Old Media. On Nov. 7 once hot file-sharing service Grokster settled its case with the film and recording industries. Grokster will unplug its Web site, cease offering download software until it comes up with a way to compensate copyright holders, and pay the plaintiffs $50 million (though sources familiar with the agreement say Grokster won't actually pay, since it has almost no money). Don't play a dirge for file-sharing, though. A small fraction of all file-swappers use Grokster, and current versions of its software will continue to operate as before. And while some file-sharing services like **eDonkey** are scrambling for legitimate partners, **StreamCast Networks,** the other defendant in the case, is still open for business and has no plans to settle.

See "File-sharing sites' new tune," www.businessweek.com/go/tbw

Pain Relief for Merck Just what the doctor ordered: On Nov. 3rd an Atlantic City jury found that Merck had properly warned about the risks of its painkiller **Vioxx** in a case involving the plaintiff's 2001 heart attack. The drugmaker has now won one and lost one on Vioxx, and the decision reinforced its pledge not to strike a massive settlement. About 6,400 cases have been filed so far. Even if this one gives plaintiffs' lawyers pause, Merck faces other major health risks. Over the next seven years four multibillion-dollar drugs, including $4.3 billion cholesterol zapper **Zocor**, lose patent protection. So what's CEO **Richard Clark's** revival plan? At a meeting with analysts, Clark said Merck could diversify into diagnostics or devices. That's a sure sign Merck's old regimen isn't doing the trick.

See "A weak tonic for Merck," www.businessweek.com/go/tbw

Controversy of the Week

Be careful who your playmates are. That's the lesson **Mattel**—and other companies—may draw from the kerfuffle swirling around its **American Girl** unit, which makes wholesome poppets dressed in historical costumes. The company gave $50,000 to and has helped raise money for **Girls Inc.,** a 141-year-old nonprofit formerly known as Girls Clubs of America. The funds backed three programs that promote such goals as building math skills. But Girls Inc. also supports abortion rights, so **Pro-Life Action League,** a group best known for picketing abortion clinics with graphic fetus photos, has called for a boycott of Mattel products, and schools have canceled American Girl fashion shows. Now, Pro-Life is organizing two protests outside American Girl's Chicago store on Nov. 25 and Dec. 3. "We have no position [on abortion]," says American Girl spokesperson Julie Parks. "We're the political ping-pong ball." Both Girls Inc. and Pro-Life Action League claim donations have risen since the tempest in a dollhouse began.

MARISOL LUNA

THE END OF TV (AS YOU KNOW IT)

In an era of on-demand entertainment, Big Media is eager to give viewers the content they want. But who will pay for it?

BY DAVID KILEY AND TOM LOWRY

THE STRING OF GROUNDbreaking deals struck on Nov. 7 has been heralded as the beginning of a media revolution. NBC Universal and CBS Broadcasting abandoned age-old policies and chose to make top shows available via video-on-demand services. Yahoo! Inc. announced that it will enable television fans who are away from home to program their TiVo digital-video recording devices remotely. "The computer has crashed into the television set," declares Brian L. Roberts, CEO of Comcast Corp., the nation's largest cable operator, which will let customers order up CBS prime-time shows just hours after they air.

But amidst all the hoopla over increasing consumer disdain for the daily TV schedule and enthusiasm for DVRs and iPods, one thing was missing: the business model. How will the producers of entertainment replace the profits they made from selling advertising aimed at a mass audience? It's going to be a painful transition, says Dennis Miller, a general partner of Spark Capital, a Cambridge (Mass.) venture-capital firm that invests in media and technology companies: "Where we are now, there is no model that makes sense."

So why the rush by media giants into the on-demand world? They're worried that audiences are fragmenting and that marketers won't keep paying for general audiences who are tuning out their messages. The Internet and handheld devices already provide access to all kinds of entertainment for a small fee. Internet ad revenue amounts to only a fraction of the $17.8 billion that network television ads generate, but the online take is growing by 40% a year. Network dollars are up only 2.6%, and that's the result of price increases that will be difficult to sustain with shrinking audiences. "We have great content. What we need are new revenue streams," says CBS CEO Leslie Moonves.

FLYING BLIND

EVEN SCARIER FOR THE networks is the growing competition from free content on the Internet. File-sharing Web sites like eDonkey, which don't charge anything, already account for half the volume of data—TV shows, movies, and music—sent via th Web in a given day. Some 3 million peopl are using eDonkey at any given time "There is no doubt that the merger of th living room TV set and the World Wid Web is coming soon," says Rishad Tobac cowala, chief innovation officer at globa ad agency Publicis Groupe.

So even though they don't yet have clear profit plan—and they risk cannibal izing some of their traditional TV fans b dangling 99¢ downloads—the network are plowing ahead. Certainly they hav watched giants in other Old Economy in dustries stumble as they try to hang on t time-honored revenue streams while nev rivals make inroads and consumer prefer ences shift. The networks, along with thei counterparts in radio, movies, and profes sional sports, need only consider old-lin companies such as Eastman Kodak which was crippled by the digital photog raphy revolution. Newspapers and maga zines face stagnant or declining reader ships and restless advertisers. So fa publishers haven't figured out the formu la for generating online revenue that' anything close to what they're makin from their struggling paper-and-ink edi

ALSO IN THIS SECTION:

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52 RIM: A $1 billion settlement ahead?

tions. And yet print-media executives concede that delivering their content electronically is critical to the long-term survival of their businesses.

The video-on-demand (VOD) phenomenon isn't confined to cable-system menus and iTunes downloads. The entire Internet is, in a sense, media on demand, says Tobaccowala. "That has changed how consumers feel toward all media, training them to feel puzzled and even cheated when they can't get what they want when they want it."

Martin D. Franks, an executive vice-president at CBS who helped forge the Comcast deal, acknowledges that offering prime-time shows such as *CSI* at 99¢ a pop is very much an experiment, not a clear path to profits. But the network knows it must adapt to changing viewer and advertiser attitudes. "We will look at how people respond, and we may adjust those prices," says Franks, who is optimistic about the foray. He offers the hypothetical case of a highly successful 8 p.m. show that snares 20% of the total viewing audience. "That means that 80% of the households aren't watching" that program, he notes. "There is just so much audience available" to whom an enterprising network can try to sell on-demand versions of the same show. Until now nearly every dollar the networks have raked in has come from commercials, with little effort being made to grab viewers beyond the living-room couch.

HOUSEWIVES IN YOUR POCKET ABC's hit show will be available on iTunes

That's why the networks are dipping their most profitable toes into unknown waters, making some of their top-rated shows available in new ways. A deal ABC struck last month to have episodes of its hit *Desperate Housewives* available for download on Apple Computer Inc. video iPods for $1.99 shows how the networks are cautiously experimenting. The series about the wacky women of Wisteria Lane generates $11.3 million in ad revenue per episode, according to Forrester Researc Inc. That translates to an estimated 45 per viewer per episode. By contrast, AB is expected to earn $1.20 per download c an episode after Apple has taken its cu Even if 20% of the show's audience shift its viewing from traditional TV to iPo and ad revenue falls accordingly, AB would still net $1.8 million more pe episode than if *Housewives* weren't avai able on demand.

But a hit like *Desperate Housewives* the exception, not the rule. The network have only a small number of highly rate shows, and it's unlikely that the dud would appeal to iPod users. It's all too ob vious that many advertisers are turnin

Don't Skip This Ad

As consumers shift from scheduled programming to on-demand, advertisers are struggling to fit their messages in, and content providers are looking for ways to make more money without adding to ever-rising fees

ON-DEMAND ADS	VERTICAL ADS	OPT-IN ADS	HYPERTARGETING	SPONSORING NO ADS
Advertisers such as General Motors are expanding tests of long-form advertising that sits on a cable system's VOD menu. Believe it or not, there's a market for watching ads: QVC, Home Shopping Network, and the billions spent on infomercials are proof. The key: People with interests in the products and services have to know the ads are there.	A promo for a movie or TV show has an icon that links the viewer to a longer trailer and interviews with stars. Suffer from osteoporosis? A 30-second ad for a calcium supplement will drive you to a 15-minute pitch about diet and other available supplements and drugs, but only if you watch the ad in the first place.	To keep the monthly cable bill down, some consumers might be willing to accept an ad package they can tailor to their interests that screens out irrelevant products. Cable companies would also like to get people to identify themselves by occupation for advertisers. Join a universe of doctors and nurses, for example, and see more drug ads.	Cable companies are experimenting with a system that anonymously tracks household viewing habits and pretty accurately determines whether viewers are male or female, teens or boomers, pet owners or not. It's not quite opt-in, but the resulting ads are at least a better fit with consumers than with the old system.	Volvo sponsors a podcast about the auto industry for car enthusiasts. Its message is at the beginning, but there's no in-program ad interruption. This happens occasionally on network TV now. But as audiences fragment and content proliferates, the expensive approach of sponsoring ad-free content becomes more viable.

You use 25 barrels of oil a year.

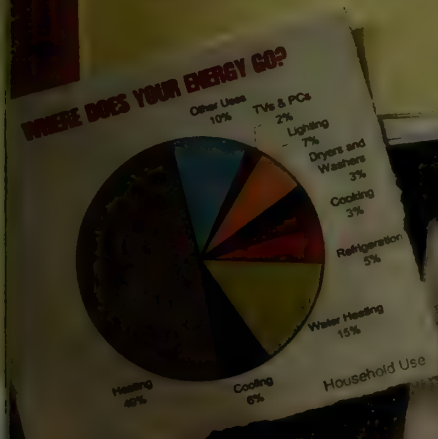
So are you ready to do something about it?

Because of surging economies in the developing world and continued growth among the industrialized nations, global energy use is soaring. As a result, supplies are tight. Prices are rising. And energy users are calling for viable alternatives.

The good news is we've got a huge source of alternative energy all around us. It's called conservation, and it's the lowest cost new source of energy we have at hand. Since 1973 alone, improvements in energy efficiency have resulted in a 50% reduction of our daily energy use, which is the same as discovering 25 extra million barrels of oil equivalent every single day. Clearly, saving energy is like finding it. But we all need to do more.

For developed and emerging economies alike, incorporating energy efficient technology into construction projects can reduce consumption by 40%. The use of more fuel efficient vehicles – including hybrids – is encouraging, and if automakers improved fuel economy across the board by just 5 mpg, we'd save over 22 billion gallons of gasoline a year. Governments and businesses need to reduce their own energy use and promote conservation to their citizens and employees. And the average person wields incredible power when it comes to conserving energy; if everyone lowered their heating temperature 6 degrees, we'd save 570,000 barrels of oil every day.

Of course, not only does using less energy mean there's more fuel to go around, it also means fewer greenhouse gas emissions. The fact is, if everyone began conserving today, we'd see results immediately. We've taken some of the steps needed to get started, but we need your help to get the rest of the way.



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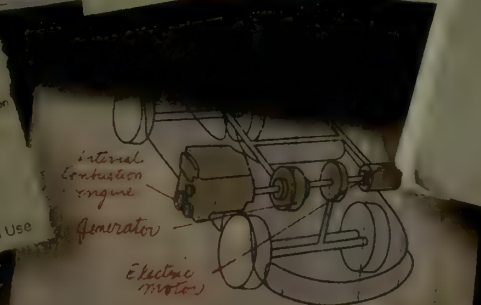

Conservation Facts:

The U.S. consumes a million dollars worth of energy every minute

•

Replacing just one incandescent lightbulb with a compact fluorescent lamp would save 500 pounds of coal and over a 1/2 ton of CO_2 emissions

•

If just one in 10 homes used ENERGY STAR®-qualified appliances, the environmental benefit would be like planting 1.7 million new acres of trees

Chevron Steps Taken:

Saving our own energy:

- Since 1992, Chevron has reduced its own energy consumption by 24%
- We use cogeneration technology at our refineries to produce additional electricity from otherwise wasted energy

Saving other people's energy:

Chevron has a separate, proven business dedicated to energy efficiency. Success stories include:

- Improvements that will lower the Northern CA postal service's electricity spending by 46%
- Helping the U.S. government save taxpayers $151 million while reducing greenhouse gas emissions by an expected 1.5 million tons

Chevron

Human energy™

away from less popular television fare. The networks have responded at times by twisting arms. To hawk their wares on *Housewives*, advertisers must comply with ABC's demand that they buy time on low-rated shows, too, as part of a package deal. It's an inefficiency that drives marketing executives nuts.

Advertisers are also increasingly skeptical of the iffy science of broadcast-TV ratings, which aim to measure various slices of the viewing audience, such as the most sought-after demographic of 18- to-49-year-olds. Video delivered on demand—whether via the Internet or cable—allows for much more precise counting, not to mention the opportunity to gather detailed information from viewers asked to register online.

As a result, "the traditional prime-time TV placement of 30-second ads is dying a fast death," says Fred Suckow, marketing director at Nissan North America Inc. The auto maker still spent $721 million on TV ads last year. But Suckow says he is more excited about the four-minute promotional films on the 350Z sports car and Titan pickup truck he has been running on DirectTV's program menu, which consumers have to click on to watch. In one of the splashy recent announcements, NBC said it would provide the DirectTV satellite network with programming.

MOVING TOO FAST?

AS NETWORKS TRY to figure out a way to make VOD profitable, they can look to their advertisers for examples. Big marketers are already exploring what consumers will tolerate—and even like—in an online ad. General Motors Corp. is expanding a program that puts short promotional films on the on-demand menus of cable systems. This idea tested well in Philadelphia, where people identified as close to buying a car showed strong interest in watching the long-form ads. TiVo, for its part, places icons on 30-second ads that drive consumers to longer promotions if they are interested.

The urgency of the networks' move online may wane in the short term before picking up again. Most baby boomers still aren't downloading free video from the Internet, and blue-chip companies are still shelling out big bucks for old-fashioned advertising on TV shows. But consumers under age 30 are tuning out, and audiences overall are splintering. Comcast carries several hundred channels of programming, but it will offer more than 4,000 on-demand features this year. And video entertainment is one of the Internet's fastest-growing draws. If network-TV audiences were futures, most investors would be selling.

For that reason, Google Inc. is the company, more than any other, that frightens the media Establishment. The company's ad revenues were $6 billion last year and are expected to be $10 billion this year. What disturbs programmers and distributors at the big networks is that the company hasn't even scratched the surface of what its search technology might be able to do. It probably won't be too long befor Google gets good at helping Web surfer find and organize all the available onlin video related to their hobbies. That pile o alternatives is likely to "eat into tradi tional TV time," says Tim Hanlon, direc tor of emerging contacts at Starcom Me diaVest Group, a media-buying agency TV networks that don't make their pro gramming similarly available could fin themselves the prime-tim equivalent of Kodak's dyin 35mm film business. "Th worst-case scenario for th networks is to sit back and d nothing," says Forrester Re search analyst Josh Bernoff.

Soon it won't be just th viewers deserting prime-tim television. Big-name celebri ties may flee, too. Radio per sonality Howard Stern is quit ting Infinity Broadcastin Corp. for Sirius Satellite Radi Inc. on Jan. 1, but he's also tak ing his huge audience to VOD format, charging $9.9 per month for 35 hours o shows. That service, iN DE MAND, is expected to hav about $750 million in rev enues this year, which in cludes some early Stern sub scriptions. If he succeeds others may follow. Top talent like Aaron Sorkin, Mark Bur nett, and Larry David coul cut out the middleman an develop programs that go straight t broadband. They'd avoid all the annoyin memos from network executives—and ge to collect the ad dollars themselves. ■

–With Ronald Grover in Los Angele

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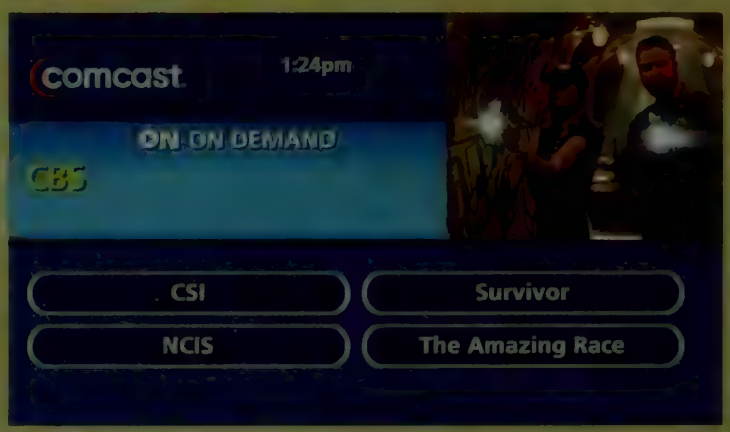

BusinessWeek online For a look at tiny tech outfits set to prosper in an on-demand media world, go to businessweek.com/extras

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RETAILING

WATCH OUT, BEST BUY AND CIRCUIT CITY

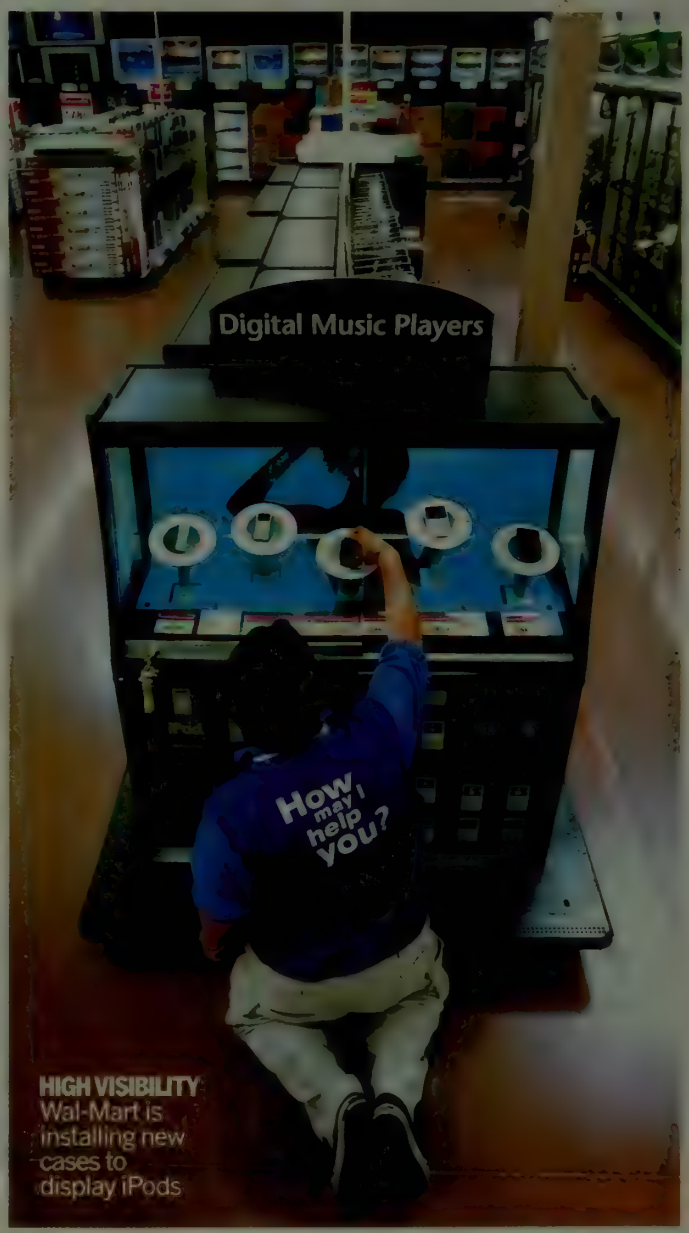
Wal-Mart is attacking their business model by offering lower-cost warranties

BY ROBERT BERNER

THIS HOLIDAY SEASON, Wal-Mart Stores Inc. has made no secret that it's gunning for the nation's two largest consumer-electronics chains, Best Buy Co. and Circuit City Stores Inc. Wal-Mart has spiffed up the interiors of many of its electronics departments and added a slew of high-end products, from Sony liquid-crystal-display televisions and Toshiba laptops to Apple iPods. It's backing the changes with an aggressive holiday marketing campaign and a big day-after-Thanksgiving sale. But here's what really has Best Buy and Circuit City worried: Wal-Mart has entered their most profitable line of business, extended warranties, and it aims to turn that business on its head.

Although they don't disclose it in their financial filings, the real earnings engine at Best Buy and Circuit City is not the sale of gadgets themselves but the sale of warranties. Those are the high-priced, multiyear protection plans on TVs, computers, and other items that are hawked by the retailers' salespeople at the close of each purchase. This fiscal year analysts estimate warranty sales will account for more than a third of Best Buy's operating profit and all of Circuit City's. On Oct. 27, Bentonville (Ark.)-based Wal-Mart attacked that profit source by launching extended warranties on TVs and computers at prices that average 50% below Best Buy's and Circuit City's, says Jane J. Thompson, head of Wal-Mart's financial services.

Best Buy is better positioned than Circuit City to take the hit because it has found more high-margin services to bolster its bottom line. But Wal-Mart's entrance ultimately puts both retailers in a bind. They can either not respond and potentially lose sales, or cut warranty prices and hurt profits. The dilemma comes at a difficult time. Prices of electronic goods are steadily falling, crimping margins for both companies. "Profit on extended warranties has always been the Achilles' heel of Best Buy and Circuit," says Todd Kuhr, a former consumer-electronics retailing analyst who is now president of Ardo Capital, a Cleveland hedge fund. "Wal-Mart is cutting right at the heart of their business model."



HIGH VISIBILITY: Wal-Mart is installing new cases to display iPods

Wal-Mart's push in consumer electronics is part of its broader effort to attract more upscale shoppers. It has found that wealthier consumers generally use Wal-Mart just for food and cleaning products. To get them to shop the whole store, Wal-Mart is upgrading its apparel, home furnishing, and electronics departments. But analysts figure that if any one of them will get traction first, it will be electronics, because it offers more respected brands.

Shoppers at the newly remodeled Wal-Mart electronics departments—1,300 of its 3,100 U.S. stores—will feel the difference walking down the aisles. The new Rogers (Ark.) store reflects the change. The entire section can be seen in a glance thanks to lower shelf heights and wider aisles than are customary at a Wal-Mart. Shoppers will find higher-quality displays packed with digital TVs, cameras and camcorders, portable DVD players, and a special display case for iPods. Wal-Mart is negotiating to add more strong brands, such as Samsung TVs. Borrowing a page from Best Buy and Circuit City, Wal-Mart has added 0% financing. Gary Severson, Wal-Mart's chief electronics merchant, says shoppers often exit Wal-Mart to buy gadgets at Best Buy and Circuit City. "I want to give them a reason not to leave," he says.

Should Wal-Mart successfully divert sales from Best Buy and Circuit, its entry into extended warranties will have

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substantial long-term impact on the two retailers' profits. On any warranty contract, Best Buy and Circuit City keep 50% to 60% of the revenue, says Jim Sebastian of SAFE LLC, a warranty consultancy involved in setting up Best Buy's program. The balance is divided between an administrative firm that handles the adjudication of claims and an insurer that underwrites the warranties. With little selling expense, the retailer's portion flows straight to the bottom line. This fiscal year, Ardor's Kuhrt estimates warranty revenues will deliver 36% of Best Buy's operating profits and all of Circuit City's.

CIRCUIT CITY Warranties help keep it in the black

Warranty Warfare

On Oct. 27, Wal-Mart Inc. launched extended warranties on TVs and computers over $300. Warranty prices are on average 50% cheaper than Best Buy and Circuit City. Here are service contract prices on a per-year basis on three items.*

	RETAIL PRICE	WARRANTY PRICE		
		Wal-Mart	Best Buy	Circuit City
RCA 52-inch HDTV projection TV	About $1000	$29.44	$62.49	$100.00
Toshiba notebook computer	$996 to $1,250	34.44	83.33	92.50
Hewlett-Packard desktop computer package	$629 to $748, including rebates	29.44	69.99	82.49

*[illegible]

Data: Wal-Mart, Best Buy, and Circuit City Web sites

EARNINGS HIT?

BECAUSE SUCH A small percentage of overall sales accounts for such a large percentage of profits at both Best Buy and Circuit, any fall in warranty sales would have a proportionally bigger hit to earnings. Kuhrt, whose hedge fund has no positions in any of the retailers, estimates that, as a percentage of overall sales, a one percentage-point fall in warranty revenue would cause an 8% drop in Best Buy's operating profit and a 29% fall at Circuit.

Apart from the cut rate, Wal-Mart's warranties will be similar to Best Buy's and Circuit's. Wal-Mart uses the same administrator and insurer for its warranties as Best Buy—N.E.W. Customer Service Companies Inc. and American International Group Inc., respectively. On a $1,000, RCA 52-inch digital projection TV, for example, Wal-Mart is charging $29 a year for an extended warranty, while Best Buy is charging $62 and Circuit $100. Wal-Mart's Severson says it's "safe" to conclude that the retailer will eventually market its pricing advantage on warranties. "It's a good story to tell."

One other big difference for buyers: Wal-Mart's extended warranties commence after the manufacturer's warranty ends. At Best Buy and Circuit, warranties begin upon the product sale, so they overlap with the manufacturer's warranty and don't give buyers much additional benefit for the first year or more. Best Buy claims that its policy would cover things a manufacturer's wouldn't, such as power surge damage. Circuit declined to comment.

Investors wouldn't know how important warranties are to Best Buy and Circuit City just by reading the financials. Circuit only discloses total warranty revenue and its percentage of total sales: $182 million, or 4% of total sales, for the first six months of this fiscal year. Best Buy used to give those figures but stopped providing them after fiscal 2001, burying it in a revenue category called "other." Then it stopped reporting that category in fiscal 2004. Spokespeople for both companies decline to give more detail.

> The push in electronics is part of an effort to woo upscale shoppers

Not all analysts are convinced Wal-Mart's move will cut into Best Buy's and Circuit's earnings. Colin McGranahan, of Sanford C. Bernstein & Co., notes that it's the sale of the gadgets themselves that drives warranty sales. He believes consumers will put Best Buy's and Circuit's greater choice before the price of a warranty. But of course, most buyers still don't realize how much more expensive their warranties are than Wal-Mart's. The test comes when they find out. Eric Arnum, editor of the online trade publication *Warranty Week*, predicts this outcome: "[Wal-Mart] is killing the goose that lays the golden egg." ■

BusinessWeek weekend For more on this story and to learn why the big-box retailers might not be the best place to buy your electronics, watch BusinessWeek Weekend. Check your local TV listings or go to businessweekweekend.com to view this and other stories from our weekly TV program.

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AUTOS

CAN GM STOP BLOWING CASH?

If not, the company won't have the money needed for a radical restructuring

BY DAVID WELCH AND DAVID HENRY

MANY A COMPANY would be happy to have as much cash on hand as General Motors Corp. At the end of September, the Detroit giant had more than $19 billion in its coffers. So why are investors getting edgy about the company's nest egg? The cash pile in GM's auto division was in excess of $29 billion back in September, 2003—meaning that the company burned more than $10 billion in two years as weak sales fell short of covering rising costs for health care, commodities, and furloughed workers. And GM could consign a further $6 billion to the flames by the end of next year, estimates bond analyst Kip D. Penniman Jr. of KDP Investment Advisors Inc.

GM seems to be getting the message. The talk behind closed doors is now about scaling back budgets for new models, reducing payrolls by tens of thousands, and shutting factories. In meetings the first week of November with executives at the troubled North American auto division, Chairman and CEO G. Richard Wagoner Jr. said they must dramatically cut spending. He is even scrutinizing new models intended to drive sales three years from now. Publicly, Wagoner has already committed to announce in December a series of plant closings and to give more detail on how he will eliminate more than 25,000 of its 110,000 auto jobs.

But making those cuts costs money, too. Downsizing figures are tough to calculate, but analysts say early pension buyouts and employee relocation costs could add up to as much as $2 billion. And if cash gets too tight, cutting product budgets could make it tougher to spark a sales turnaround. Plus, if current talks between the United Auto Workers and bankrupt parts-maker Delphi Corp.—GM's biggest supplier—end up in a strike, GM could be shut down. Goldman Sachs Group analyst Robert Barry estimates that a strike shutting down GM would cost the auto maker $2 billion a month. Also, GM may have to cut a pricey deal with Delphi or the union to head off a strike.

BURN RATE

GM Auto's cash on hand dropped $10.1 billion in two years

THE LAST CROWN JEWEL

FOR ITS PART, GM is clearly in restructuring mode. But Wall Street wants to see GM and the union cut more deeply than they have in the past. Both sides have long resisted an overhaul, hoping future market share gains and GM's 5% annual attrition rate would match plant capacity with car sales.

Temptation to stall again could come when GM sells 51% of its financing division, GMAC, as it promised to do on Oct. 17. The sale could yield as much as $12 billion in cash. But GMAC is GM's last crown jewel and has delivered $1.5 billion in cash dividends to the auto division so far this year. Some analysts worry that the GMAC sell-off will reduce the pressure on executives to undergo a major restructuring that would deliver profits even if sales continue to fall in coming years. "If they don't seize the opportunity and do major restructuring, they're going to look up two or three years from now and be close to being out of cash," says Shelly Lombard, a senior credit analyst at Gimme Credit Publications.

Radical restructuring won't be easy for a company that is genetically engineered to maintain its size and market share at nearly any cost. Union contracts thwart plant closings and all but prohibit firing of factory hands, who get paid at least 75% of their wages when furloughed. To date, GM has cut factory jobs only by retiring workers after 30 years of service. Right now, GM's 5,000 idled U.S. workers are costing Wagoner $500 million a year in cash. Wagoner

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SUCCESS FOLLOWS SUCCESS.

did make a small first step in October by securing an agreement from the UAW to slash $1 billion a year in staff health-care outlays. "The health-care cuts help," Wagoner said in an October interview with *Business Week*. "But we don't have a one-point turnaround plan."

More cuts are now in the cards. Wagoner has told Wall Street that he intends to have manufacturing capacity reduced so that it matches demand by 2008 "if not sooner." The cuts could come with Wagoner starting to ax capacity by at least 600,000 vehicles next year. Three assembly facilities that are already idled—an SUV plant in Linden, N.J.; a van plant in Baltimore; and a midsize-car plant in Lansing, Mich.—could be first. Other assembly facilities may also go—possibly a truck plant in either Janesville, Wis., or Pontiac, Mich. Another SUV factory in Oklahoma City and a minivan plant in Doraville, Ga., are at risk, too. GM may also discontinue a couple others that make engines or steel body panels. If Wagoner closes five factories, GM would have the capacity to make only around 4.7 million vehicles a year. Should sales continue to fall, more factories could be shuttered later, says one company source.

A recent pact cuts $1 billion a year in health spending

With less capacity, GM could start to douse the cash fire. It would no longer have to force-feed the market so much. It could cut back on discounting its models, thus earning better net prices. The company fetches net revenue per vehicle of $21,000—about $3,500 less than Toyota Motor Corp., according to Harbour Consulting Inc. in Troy, Mich. "If something is relatively scarce, you can get a better price," says Sanford C. Bernstein analyst Brian Johnson.

Some investors fear that GM and the UAW will stick with their bad old habits of keeping furloughed workers on the payroll when they close a plant, on the chance that another plant will be able to use them. "Investors are worried that they will close plants but won't address the labor costs," says Goldman's Barry.

GM is wise to make some deep cuts while it has the cash to get it done. As one shareholder puts it: "The bad news is, GM has a lot of problems. The good news is, they have the cash and liquidity to fix it." ■

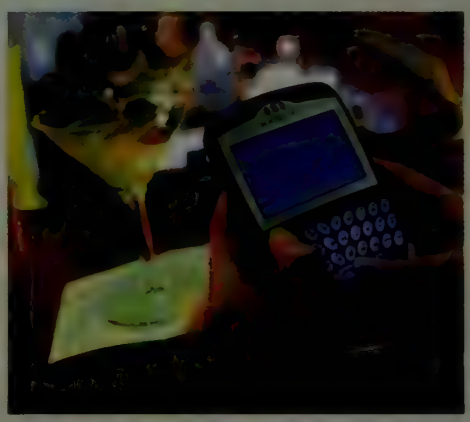
LAWSUITS

NASTY THORNS IN THE BLACKBERRY PATCH

Research in Motion may have to cut a check for up to $1 billion to settle its patent suit with NTP

BY ROGER O. CROCKETT

THINGS ARE LOOKING DICEY for Research in Motion Ltd., maker of the cultish BlackBerry e-mail device. On Nov. 9, U.S. District Court Judge James Spencer made it clear he was growing increasingly impatient with the protracted battle between RIM and tiny tech investor NTP Inc., which alleges that RIM's wireless e-mail technology infringes on several of its patents. He also said he was "very unlikely" to accede to RIM's request that he postpone the case to give the U.S. Patent & Trademark office a chance to weigh in: "I've spent enough of my life and time on NTP and RIM."



ELEVENTH HOUR A patent office review has been delayed

With Spencer pushing to wrap things up, a settlement seems increasingly likely. And it could be a great deal higher than the $450 million RIM and NTP agreed to before talks collapsed in June. Some analysts say RIM could end up cutting a check for $1 billion.

KEENER COMPETITION

THAT'S A LOT of BlackBerrys—about three million for anyone who's counting. And it will be especially painful for RIM to pay out in the face of stiffening competition. But the Canadian company may have little choice. Barring a settlement, NTP has asked the judge to shut down RIM's U.S. operation. "NTP is in the driver's seat," says James F. Hurst, a patent litigator at Chicago law firm Winston & Strawn LLP. "The validity of RIM's entire business is arguably at stake."

What's RIM's next move? Co-CEO James L. Balsillie hopes to convince the judge to enforce the aborted $450 million settlement. NTP says the agreement was never finalized. If the judge agrees, analysts expect him to give the two sides a couple of weeks to work out a new deal. An emboldened NTP would have the leverage to ask for more money—a sum that could be $600 million to $1 billion plus an 8% to 9% royalty, according to Citigroup Global Markets. With that kind of cash in its sights, NTP might figure, "why press for pennies?" says Citigroup analyst Daryl Armstrong.

Could RIM afford to pay that much? Sure. The company has some $1.2 billion in cash and is expected to earn about $500 million on $2 billion this fiscal year. But RIM is entering a difficult period in its young life. Its popular new BlackBerry aside (page 24), RIM is under fierce attack. Citigroup's Armstrong says RIM's partners worry about its fate—opening the door for competitive vendors such as Microsoft, Intellisync, and Palm Inc. to steal business. Customers such as Cingular Wireless say they're loyal. But that could change.

RIM has an additional worry. Legal experts suggest that if the company ends up settling for more than the $450 million it announced in June, shareholder lawsuits are a given. Disgruntled investors who saw their stock jump on news of a supposed settlement—only to watch it slide 21%, to $61.22, since—will likely bring class actions.

No doubt, Balsillie understands all this. Bet on him to swallow his pride and play nice with the judge. ■

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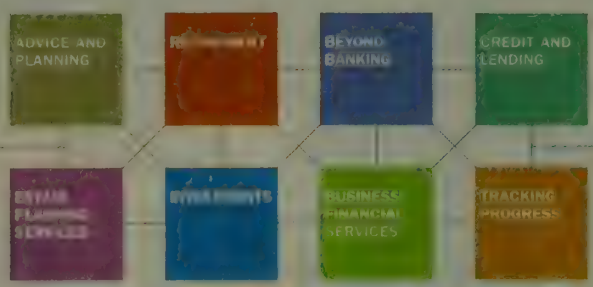
-The Kilborn Team, Merrill Lynch Financial Advisors



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INSTRUMENTS FOR PROFESSIONALS

DITED BY LEE WALCZAK

Free Trade: Forget The Fast Lane

OVEMBER HAS TURNED OUT to be a cruel month for U.S. multi-ationals fighting for a new global trade agreement. President ush's Nov. 3-4 trip to a regional trade summit in Argentina end-d in rioting in the streets of Mar del Plata and failure at the ne-otiating table. And with a key conclave of rich and poor nations oming in Hong Kong in December, the ord from negotiators is grim: Hopes for ajor new tariff reductions are fading, arking the fourth year that the Doha ound of trade liberalization has re-ained deadlocked.

No one ever said that the fight for free ade was easy, especially in light of rising ublic opposition to globalization. But hile Administration trade officials vow ot to turn back, the President may have no oice but to shift his fo-us from Big Reform to cremental gains.

Doha was launched in 001 amid high hopes at U.S. and European rm subsidy reductions ould help developing ations and spur global rowth. By also lowering arriers on food imports Europe, the U.S., and pan, the pact aimed to olster many African, sian, and Latin Ameri-an economies where up two-thirds of the popu-tion works in farming. At the same time, e U.S. hoped to end rampant Third Vorld piracy of patents and copyrights nd to lower tariffs on U.S. exports while creasing overseas opportunities for U.S. ervice companies.

NEW TACK? Bush on his ill-fated trip to Argentina

he Art of the Possible

NSTEAD, DOHA HAS become a Rubik's ube of interlocking parts, few of which are ligned. France has balked at trimming ubsidies to its inefficient farmers and reatens to capsize a modest European Union subsidy-trimming plan. Developing ations, led by Brazil and India, threaten to etain import barriers and keep making nockoff pharmaceuticals and software. The upshot is that Doha is pinned under the weight of its own ambitions.

But trade experts say that considerable progress could still be made if the process were scaled back. After all, the Clinton Administration accomplished much outside of the framework of massive trade talks, forging pacts with China and with NAFTA partners Mexico and Canada, and leading the world to a global telecom accord. Indeed, the eight-year-long Uruguay Round talks that created the World Trade Organization in 1995 left everyone so exhausted that the signers predicted it would take years for the developing world to adjust. That's proving prescient.

The key to a more manageable Doha deal: Pursue the art of the possible. "Each side could agree to take something off the table," says Kimberly Elliott, an analyst at the Center for Global Development. To facilitate trade flows, rich nations could increase aid to poorer states for road and port construction. Poor nations could agree to let Europe and America keep some protections on sensitive farm sectors such as dairy, meat, and sugar. Washington could ease off its demands for dramatic drops in barriers to trade in services and for an abrupt end to generic drug-making in the developing world.

Clearly, neither the EU nor the U.S. is ready to confront politically powerful farm interests. But most of the 148 WTO members believe in the goal of free trade. That's why they are members. Their citizens, though, are less comfortable with the wrenching changes wrought by rapid globalization. A few years of consolidation and slower change may be the ticket now. ■

–By Paul Magnusson

CAPITAL INSIDER

WHEN IS A HURRICANE LOSS NOT A LOSS?

NORTHROP Grumman reported that shipbuilding profits in the third quarter were off by $165 million due to Hurricane Katrina, but shareholders can take heart. If the **U.S. Navy** gets its way, the company will get a cash infusion far greater than that. The Navy wants to pour nearly $2 billion into **Northrop Grumman's** shipyards in Louisiana and Mississippi. The tab covers everything from the costs of labor disruption to replacement of technical manuals and other items assumed to be destroyed.

Not everyone is onboard. "Something's rotten in Denmark," says a Senate GOP aide. "Why should U.S. taxpayers pay these costs?" One reason is the government insures arms makers against acts of nature. A company spokesman says the cash will cover the Navy's losses and get shipbuilding back on schedule.

BUSINESS LOSES A BET IN VIRGINIA

IN BUSINESS, timing is everything—and Virginia groups' timing was lousy this year. With GOP gubernatorial candidate **Jerry Kilgore** leading in October polls, business organizations hopped on his bandwagon. Backers included many executives who four years ago had supported Democratic Governor **Mark Warner,** a former wireless telephone CEO.

But Kilgore's corporate corps miscalculated. The Republican's campaign cratered, and Lieutenant Governor **Tim Kaine,** a pro-business, fiscally conservative Democrat, easily won. Kaine says he'll forgive old differences and work with business to build Virginia's economy. But Democrats are unlikely to forget anytime soon.

CHINA

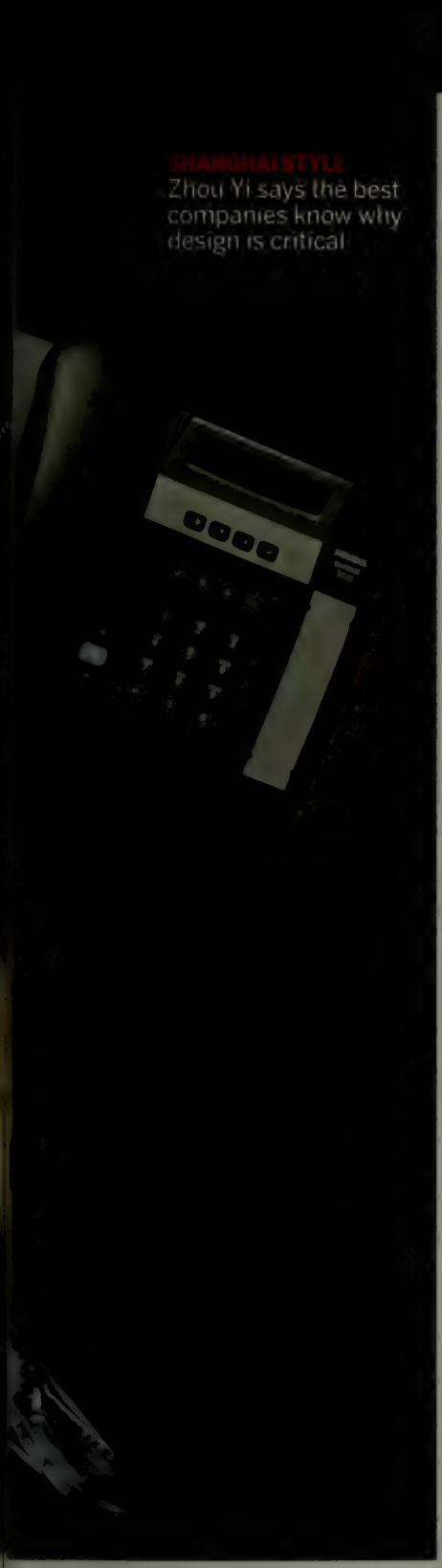
CHINA DESIGN

How the mainland is becoming a global center for hot products

BY DAVID ROCKS

SONY HAD A PROBLEM IN China: The company was seen by many young Chinese as Daddy's brand. So in August Sony opened a design center in Shanghai. The three designers there quickly set about trying to understand the lives of young Chinese, giving 50 of them digital cameras and asking them to document their daily lives in photographs. By September the designers had tacked dozens of the pictures—people in their bedrooms, hanging out with friends, playing basketball—onto the wall and divided the group into seven categories, such as "Cheerful Next Generation" and "Try Hard for Life." Then the team set out to design a line of MP3 players that would appeal to the trendsetters in these groups. The devices, in muted colors with a smooth river-rock-like appearance, are scheduled to hit the market in China early next year. "If we understand [young Chinese], we can design better products for them," says Katsumi Yamatogi, the veteran Sony Corp. designer who heads the Shanghai studio.

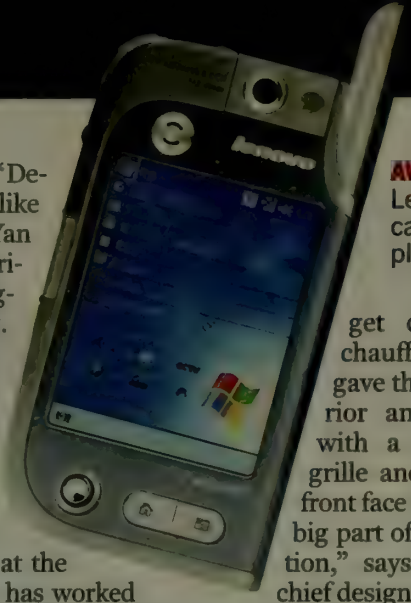
There's a lot of that going on in China these days. As Chinese companies seek to build global brands and U.S., European and Asian multinationals aim to boost sales in the mainland, they're transforming the country's design business. Chinese manufacturers realize they need better products if they want to break out of China and beef up their margins on sales abroad. And the likes of Sony, General Motors, and Motorola are starting to see that as Chinese consumers get more discriminating, they're no longer content



SHANGHAI STYLE Zhou Yi says the best companies know why design is critical

ith the tired, designed-somewhere-else odels many multinationals once sold in hina. For American companies who play is shift right, better design could result greater sales of higher-margin prod- cts to mainland consumers.

The race toward better design in China certainly intensifying. The best Chinese ompanies are building their design staffs r hiring outsiders to help them make ore products of their own. China has ome 400 schools offering design classes at together graduate some 10,000 in- ustrial designers annually, up from just 1,500 or so five years ago. "Design schools are popping up like bamboo shoots," marvels Yan Yang, chairman of the industrial design department at Tsinghua University in Beijing. And hundreds of design consulting firms have sprung up in Shanghai, Beijing, and Guangzhou. "Large companies [in China] are saying: 'We can't catch up fast enough,'" says Craig M. Vogel, a professor of design at the University of Cincinnati who has worked as a consultant to several companies in China. Even young designers from abroad are flocking to Beijing and Shanghai to try their luck in the world's most dynamic consumer market (page 60).



AWARD WINNER Lenovo's ET960: a camera, an MP3 player, and a phone

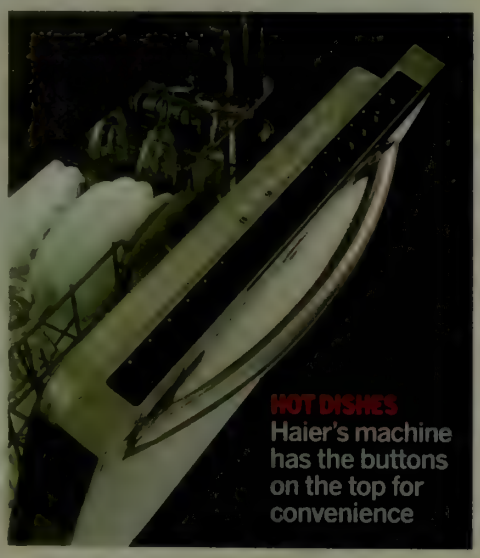
SAMSUNG WANNABES

THAT'S A DRAMATIC CHANGE from just a few years ago. Although China manufactures the bulk of the world's electronics, shoes, and much more, those products typically have been designed in the U.S., Europe, or Japan. When Chinese companies did make their own products, as often as not they copied designs from abroad. Today, in contrast, just about everyone in China seems to want to be the next Samsung. A decade ago the Korean conglomerate was a second-tier brand that made me-too consumer electronics. But after years of focusing on design, Samsung today earns more awards for design than even Sony or Apple Computer and is one of the world's most valuable brands. "Design is the way companies improve their competitiveness," says Yu Zida, a vice-president who oversees design at appliance maker Haier Group Co.

As locals get better at design, multinationals are realizing that they need to develop products specifically for the Chinese. So Sony, Samsung, Motorola, Nokia, General Motors, Volkswagen, and many others have opened design shops in China to research local tastes. Not so long ago, General Motors Corp. made few changes to models sold in the mainland, figuring consumers buying their first cars wouldn't be too choosy. But as competition has picked up, its Chinese design team has nearly tripled—to more than 80 people—since 2002. While they have developed a few concept cars, most of their time is spent tailoring vehicles developed elsewhere to the Chinese market. In one case, GM took a family minivan sold in the U.S. as the Chevrolet Venture and restyled it as a car for executives, calling it the Buick GL8. To boost its appeal to big shots who get driven around by chauffeurs, the designers gave the GL8 a tonier interior and a longer hood, with a more pronounced grille and headlamps. "The front face of the car becomes a big part of the design inspiration," says James Shyr, GM's chief designer in China. "One of the key requirements of an executive car is you have to see it from far away."

Some Chinese designers call that sort of ostentation "gold teeth design." It's a hit in China, where it's more important to appear rich than to have a fat bank account. That means companies both foreign and local often trot out products that sell well in China but might not have much resonance in other markets. Lenovo Group Ltd., for instance, has had fabulous success with a cell phone that holds a few drops of perfume, filling the room with sweet smells as the battery heats up. And Volkswagen designers in Shanghai have for the first time been permitted by the company's design bosses to use artificial wood in a car. While customers in Germany would turn up their noses at a car with fake wood—even if "real wood" is just a veneer that's less than a millimeter thick—Chinese car buyers want it because it makes their autos stand out. "Understatement in China is a no-no," says Stefan Fritschi, chief designer at VW's Shanghai operation. "You want to impress your neighbor."

Is design in China at the same level as in Japan or Korea? Not yet. The quality of instruction can be spotty. While China's



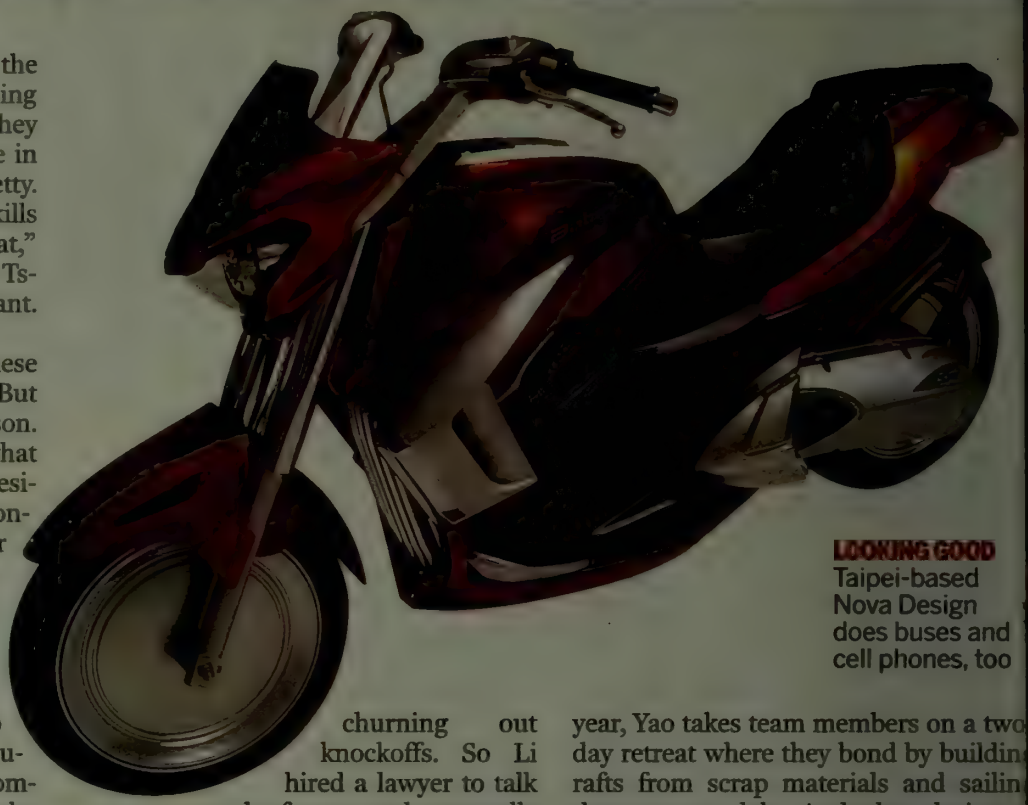
HOT DISHES Haier's machine has the buttons on the top for convenience

design schools are good at teaching the creation of pleasing forms and using computers to render new products, they need to give students more guidance in design that is usable as well as pretty. "The difference between technical skills in China and the West isn't that great," says Liu Guangzhong, a professor at Tsinghua and an independent consultant. "The problem is in innovation."

The other issue: The best Chinese companies know design is crucial. But others still haven't learned the lesson. "Manufacturers don't think about what makes good design," says Zhou Yi, president of S.point Design, a Shanghai consulting firm that has done work for Siemens, Intel, and many Chinese companies. "They really just focus on looks rather than functionality."

Then there's piracy. Just about any successful product in China quickly gets copied, a powerful disincentive to invest in design. GM, for instance, is suing Chery Automotive Co. for its QQ compact, a dead ringer for the Chevrolet Spark. And Motorola Inc. noticed copies of the A780, a PDA-phone combo its Beijing staff developed for the Chinese market, within eight months of the phone's debut. "I'm amazed at how efficient they are," says Kumo Chiu, who heads Motorola's Chinese design operations.

Still, the situation is improving fast. Li Yiwen, a professor of design at Shenzhen University and an independent designer, came up with a basic Web camera design that has been branded and sold worldwide by the likes of Samsung, Yahoo!, and Lenovo. Shortly after the camera hit the market, a factory in Shenzhen started churning out knockoffs. So Li hired a lawyer to talk to the factory and eventually settled for a payment of $63,000. "I was pretty satisfied with that," says Li.



LOOKING GOOD Taipei-based Nova Design does buses and cell phones, too

The changes can be seen at the best Chinese companies. Lenovo has doubled its design team, to 80 people, since 2002. The computer maker—which bought IBM's PC Div. in May—this year won an Industrial Design Excellence Award for its ET960 smart phone. Yao Yingjia, Lenovo's chief designer, has broken down much of the Confucian hierarchy that is a deterrent to innovation at Chinese enterprises and employs many of the same management techniques embraced by industry leaders worldwide. Every year, Yao takes team members on a two-day retreat where they bond by building rafts from scrap materials and sailing them across a lake. And when designers are working on, say, a new cell phone or laptop, they take over a "war room" for the duration of the project. There, team members paste photos of competing products on the wall, brainstorm about the attributes of the device, carve clay mockups, and immerse themselves in the project for weeks or months. "Asian culture is very top-down," says Yao. "But if you give your people too much direction, you won't get any surprises."

MOTOROLA A780 The PDA-phone was designed in Beijing

Change of PLAN

China manufactures the bulk of the world's DVD players, cell phones, shoes, and more. But rarely have those products been designed in China. Now, Chinese design is finally taking off. Here's why:

Brand Boost

» Chinese companies hoping to build a global brand know they need distinctive products to stand out. So enterprises large and small are focusing on design.

More Money

» Products designed in-house offer better profits. Pet toy manufacturer Soleil China says it gets 10% margins on its own designs, vs. 2% to 4% for items designed by others.

Revenue Building

» Products that satisfy targeted customer groups sell better. So Haier designs its washing machines for specific markets. One aimed at Saudi Arabia, for instance, has a huge tub for bulky robes.

Class Consciousness

» China's universities are increasing their focus on design. Some 400 schools now offer classes in the field, and 10,000 students a year get degrees in industrial design, up from about 1,500 five years ago.

Going Native

» Foreign companies are realizing that Chinese consumer tastes differ from those in L.A., London, or Tokyo. So GM, VW, Samsung, Sony, Motorola, Nokia, and others now have designers in China.

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and as a manager I like to be surprised."

Some of the best surprises, Yao says, can happen when his designers combine traditional elements of Chinese culture with cutting-edge technology. In one instance, a designer charged with developing a speaker phone modeled his proposal after the traditional Chinese "hot pot," a serving dish that families place in the middle of the table and share. "This is a great example of a product that combines culture, style, and function," says Yao.

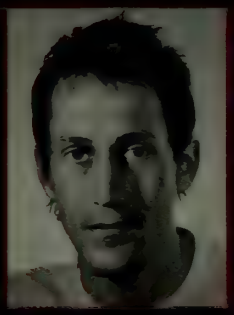
The best Chinese companies also are showing a commitment to getting designs right if they don't work out the first time. Haier, for instance, discovered through its research that people in Saudi Arabia like extra-large washing machines to hold the bulky robes that are common there. So the company started shipping a machine with a wash tub that could hold 13-lb. loads, but it didn't sell particularly well. Two years later the company increased th size of the tub to 20 lb. It sold a relative disappointing 6,000 units. In Februar Haier tried again, this time with th biggest tub it makes—26 lb. The produ has been a hit, selling 10,000 machine since its launch.

That's emblematic of the kind of a tention that Haier pays to design. Th company has 120 industrial designe and 25 more people doing consumer r

Betting on the DRAGON

As design booms in China, the country has become a magnet for young designers from around the world. Here are five who have decided the mainland is the place to get ahead.

Florian Petri



AGE 32

JOB Designer, Lenovo Computer

HOMETOWN Darmstadt, Germany

Petri was designing office furniture in Berlin but wanted to try his hand at high-tech products. He managed to swing a one-year gig at Lenovo, where he is helping to conceptualize the future of notebooks.

"Everybody knows that China will be very big and important in electronics in a few years," Petri says.

Treasure Hinds

AGE 32

JOB Team leader, S.point Design, Shanghai

HOMETOWN Seattle

After seven years working as a designer in the U.S., Hinds was ready for a change. So when she heard of an opportunity to work at Shanghai design shop S.point, she jumped at the chance.

"I have more responsibility here," Hinds says. "And I'm working to try to bring in business."

Kevin Ho

AGE 28

JOB Student, Tsinghua Univ., Beijing

HOMETOWN Cupertino, Calif.

With a BS in business management from UC Davis, Ho decided to shift gears and try design. He signed up for a $5,000-a-year master's program at Tsinghua, and plans to work in China when he's done in 2007.

"I'd like to be a bridge between the two cultures," Ho says. "That's where I can do the most good."

Eric Chen

AGE 34

JOB Designer, Motorola, Beijing

HOMETOWN Los Angeles

Though he was born in Taiwan, Chen moved to L.A. at age nine and attended Art Center in Pasadena, a top U.S. school. While at Philips in Silicon Valley, he was invited to design handsets for Motorola in Beijing—an offer he couldn't refuse.

"China is the largest mobile-phone market in the world," says Chen. "It's a real challenge for a designer."

Lars Blacken

AGE 28

JOB Freelance designer, Samsung, Shanghai

HOMETOWN Seattle

Blacken was struggling to build an independent design shop in the U.S., so he moved the operation to China. He has since taken on freelance jobs and has worked as a contractor for telecom gear maker Huawei and Korea's Samsung.

"I fell in love with the frenetic pace over here," says Blacken. "The business opportunity is so much better."

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search. Product managers for each model line are responsible for following trends in various countries. So besides the Saudi machine, there's a tiny one for rural China that costs just $38. One for India, where the power supply is iffy at best, can handle dramatic fluctuations in voltage and will pick up where it left off if the electricity goes out. A dishwasher for the U.S. market features the controls on the top surface of the door rather than on the front so you can choose the cycle you want by pulling open the door a bit and looking down at the machine from above. "[American] consumers complained to me that it's not convenient to control the machine from the front," says Shen Weibin, the machine's designer. "I realized I could put the controls on top of the door."

PET PROJECTS

EVEN SMALL COMPANIES are starting to understand the benefits of good design. Guangzhou exporter Soleil China Ltd. has been selling toys for pets since 1994. By 2000 more than 200 factories in China were making pet toys. So that year Soleil hired a designer to give its goods an edge. "We immediately saw better results when we started designing our own products," says Kate Feng, Soleil's general manager. Today she has four people creating toys and a half-dozen others helping make molds and controlling quality at factories. From their small corner of Feng's Guangzhou headquarters—a jumble of pink leashes, squeezable rubber steaks, and plastic doggy Santas for Fido's stocking—Soleil's designers come up with at least five new products a month. Each can be sold at margins of 10%, vs. 2% to 4% for items designed by foreign customers but made by Soleil.

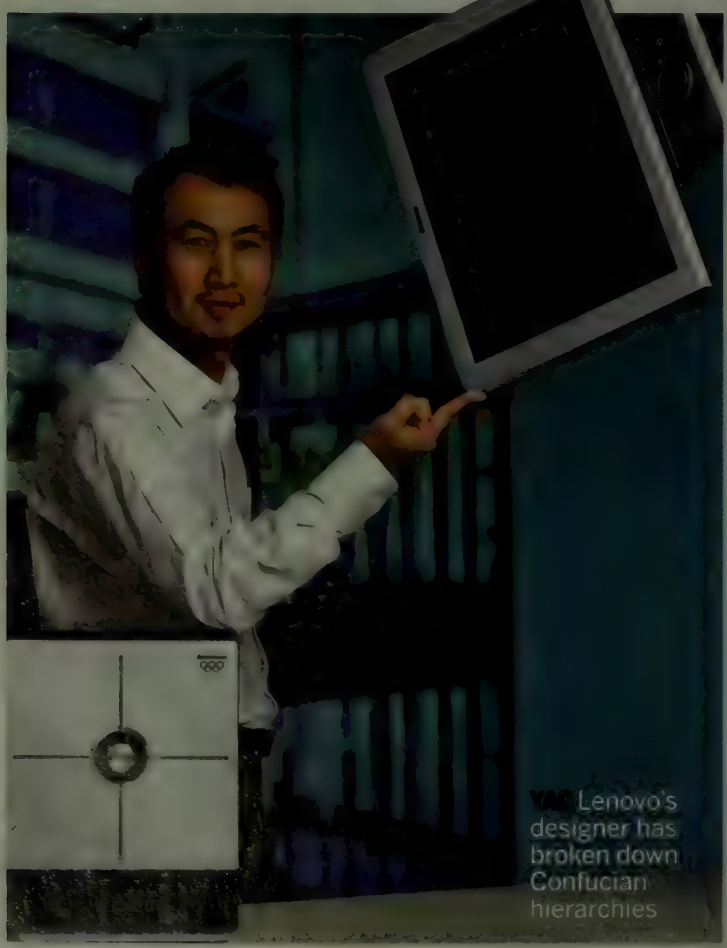
Since Soleil's wares regularly show up on the shelves of U.S. chains such as Target, Wal-Mart, and PetSmart, its success raises the question: Will the Chinese start doing design work that once would have been done in the West? That idea has designers from London to Los Angeles abuzz, fearing that their jobs could migrate to less expensive shops in China or India.

In some instances that is happening already. Taipei-based Nova Design opened a Shanghai branch in 2002. Now it employs 130 people, even as the head office has shrunk to about 50 people from 70 a few years back. Designers in China earn about $350 a month to start—less than half what their counterparts in Taiwan mak "This is a huge market," says Wen-lon Chen, president of Nova, which has de signed everything from cell phones t motorcycles for Chinese manufacturers

Will U.S. companies follow Nova's ex ample and employ low-cost Chinese de signers to come up with products for th American market? GM's Shyr calls his de signers "foot soldiers" who understan Chinese culture and therefore can help th auto maker sell more cars in China. Bu Shyr doesn't expect his foot soldiers t start helping their Detroit colleagues wit the styling of cars made for U.S. drive anytime soon. Designers in Detroit "kno exactly what's going on in Springfield, an we don't," says Shyr.

Still, the Japanese and Koreans figure out what's going on in Springfield, an their designs eventually succeede worldwide. Many Chinese designers hav already started working overseas. Onc these people have spent a few years in Mi lan, Tokyo, or New York honing thei skills, some will doubtless return to Chin to help the mainland reach the next leve It could be many years before the desig skills of Chinese companies are up t those of a Samsung. But as China devel ops, plenty of mainland companies wi certainly keep trying. ■

GM PROTOTYPE The carmaker's Chin design staff has tripled in three year



YAO Lenovo's designer has broken down Confucian hierarchies

China's Design Renaissance

Test Your Auto Smarts Think you know cars? Prove it by taking a quiz on the differences between designs for China and for other markets

Motorola's China Chief Michael Tatelman A discussion of the phonemaker's handset design strategy in China

Faces of Chinese Design Meet the personalities behind the mainland's rise in design

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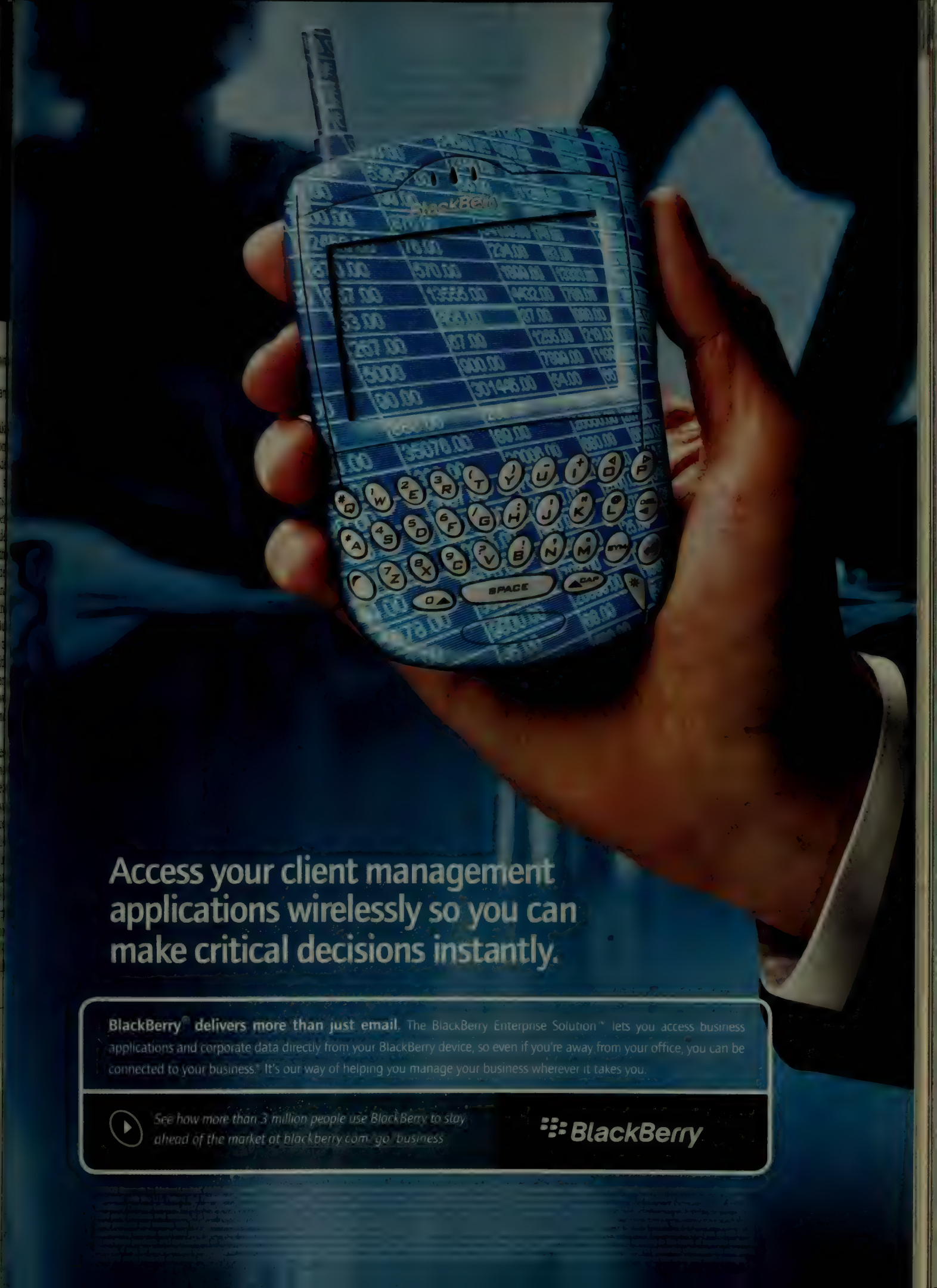
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JAPAN

A GROWTH ENGINE SPUTTERS

Nissan's U.S. sales are cooling—and may signal broader problems with its strategy

BY KENJI HALL

IN LATE SEPTEMBER, NISSAN Motor Co. reached a milestone, beating a self-imposed deadline with just days to spare. In three years, Japan's second-largest auto maker had managed to lift global sales by a million vehicles, to 3.6 million. It was a triumph for Chief Executive Carlos Ghosn, who runs Nissan and, since last April, France's Renault.

But Nissan execs had little time to savor their achievement as they started to fret about problems building in the U.S., their biggest market. High fuel prices are denting sales of trucks and sport-utility vehicles. And the introduction of new models has been delayed. All that comes as many forecasters expect demand for cars overall to cool off. "I haven't been very bullish on the U.S. market," Ghosn told reporters recently.

His worries seem justified. On Nov. 1, Nissan reported October U.S. sales dropped 13.3% from the previous year for its Nissan and Infiniti brands combined. By contrast, Toyota Motor Corp. saw a 5.2% rise, while Honda Motor Co. added 4.2%. High gas prices drove down sales of the Titan pickup and big SUVs such as the Armada by 14.9%. Surprisingly, sales of mainstay Nissan and Infiniti car models didn't fare much better, down 11.9%.

Analysts say the problem is that the impact of Ghosn's reforms is wearing off. He ran Nissan, which is controlled by Renault, from Tokyo until early this year, relentlessly driving it to higher sales and earnings by revamping its lineup and imposing dramatic cost cuts. As a result, Nissan's profit margins have been the best in the industry.

Now the momentum is slowing. This year the company forecasts operating profit will climb 3.3%, to $7.5 billion, on a 4.9% rise in revenues, to $76.6 billion. That's below the 4.4% profit gain recorded last fiscal year and much less than the heady double-digit annual increases in the three years before it.

LETDOWN A dealership in West Allis, Wis.

Loss Leader

Nissan's October vehicle sales in the U.S. plummeted even as its Japanese rivals' sales rose

COMPANY	NISSAN	HONDA	TOYOTA
YEAR-ON-YEAR CHANGE IN OCT.	–13.3%	+4.2%	+5.2%

Data: BusinessWeek, companies

Some trace Nissan's problems to t the fact that Ghosn now divides his tir between Nissan and Renault; they a whether Toshiyuki Shiga, Nissan's ch operating officer, is up to the task of ru ning the company day-to-day. Compa officials defend Shiga, who has only be on the job seven months as COO. And i vestors seem content to give Shiga a Ghosn the benefit of the doubt. Nissa share price hit a two-year peak in ea October. Fans of the stock point to stro first-half earnings, released on Oct. 28.

BIG METAL

NISSAN OFFICIALS SAY a dearth of ne models is the biggest reason for the slo down in U.S. sales. By March, 2006, Ni san will have gone 12 months without a c launch in the U.S. The drought will end May, when the Versa subcompact hatc back, sold in Japan as the Tiida, hits Ame ican showrooms. The $12,000 car will Nissan's answer to Toyota's Scion bran aimed at Gen Y consumers. It's a turn aw from Big Metal toward smaller, fuel-ef cient vehicles. By next autumn, the Sent and Altima sedans, Nissan's biggest selle in the U.S., will undergo model chang Nissan will introduce a hybrid Altim then, too. "We've asked for more Sentr Altima, and Murano, a fewer full-size trucks a SUVs," says John E. "Je Connelly, Nissan Nor America senior vice-pre ident. "I wish they we here now."

So do Nissan deale The company had bee counting on rolling o an all-new Sentra this a tumn. But after a foc group of custome panned the desig Ghosn postponed t launch and sent desig ers back to the drawi board. The delay h forced Nissan to sti with its current Sentra f a sixth year, an unusual long stretch. Once t rollouts take plac though, Ghosn is certa things will turn arou "The brand will be mu stronger than it has e been," he says. Nissa U.S. dealers only ho he's right. ■

–With Ian Rowley Tokyo and Christoph Palmeri in Los Angel

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A Renegade Looks Beyond Siberia

"I HAVE BEEN IN THE LAND OF THE DECEMBRISTS, political prisoners subjected to hard labor and uranium mines," declared Russia's best-known prisoner, drawing a parallel between himself and famous Russian dissidents of the past. In full-page advertisements in major Western newspapers on Nov. 2, former oil tycoon Mikhail Khodorkovsky, now serving an eight-year sentence at the remote Krasnokamensk Penal Colony in Siberia, sketched a vision for "Russia's development for the 21st century," including "a new political elite" willing to "say 'no' to the repressive machinery of a criminal bureaucracy."

A political manifesto? Or a desperate bid for survival? Possibly both. Three of Khodorkovsky's former business associates, who underwrote the advertisements, say concern for his safety is the main motive for the publicity. "There is a conspiracy not only to isolate him but also to kill him," claimed Leonid Nevzlin, a former partner at a recent press conference in Tel Aviv, where he fled after a Russian warrant was issued for his arrest in 2004. Conditions in Russian prisons can be dangerous, and Khodorkovsky's backers fear a nearby uranium mine may have released radiation, though the authorities deny it.

KHODORKOVSKY
Politically active via the newspapers

Principles Over Profit

WHETHER OR NOT the former chairman of oil giant Yukos is genuinely fearful for his life, his lawyers vow to take his case to the European Court of Human Rights in Strasbourg. They will argue that he is a political prisoner and didn't get a fair trial. At the same time it looks as if Khodorkovsky, who was convicted of tax evasion and fraud after financing opposition political parties two years ago, still has political ambitions. Long-standing Moscow rumor has it that Khodorkovsky could have avoided prison and stayed in business had he been willing to cut a deal and flee the country. He even has a business to run. Group Menatep, the holding company he and his partners created, has assets abroad—including GTS Central Europe, which owns telecom service providers in the region, and a 26% stake in Modgal Industries Ltd., which controls a leading Israeli petrochemicals producer. But last January, Khodorkovsky handed his 60% stake in Menatep to Nevzlin. "Prison will rescue Khodorkovsky from his oligarchic image and turn him into a politician of the new generation," says Stanislav Belkovsky, a political analyst linked to the left-wing opposition.

Khodorkovsky is up for parole in '07, but his release is unlikely with Putin in power

Behind bars, Khodorkovsky has been active politically. In September he ran for parliament but was disqualified after a court upheld his conviction. Supporters say he's working on a political program to be published soon. "His voice will ring like a bell in the political desert created by the present authorities," says Ivan Starikov, a leader of the opposition Union of Right Forces who managed Khodorkovsky's parliamentary campaign.

Yet if he is serious about a political career, he must overcome the hostility of the Russian public. In his statements, he has been leaning to the left, denouncing poverty and social injustice as well as authoritarianism. He has called for "a broad social-democratic coalition" including Communists and right-wing pro-market groups. But so far, few ordinary Russians seem impressed. An October opinion poll by Moscow's independent Levada Center found that only 18% of Russians sympathize with Khodorkovsky—and 67% don't. "As a so-called oligarch, such a figure is disliked by most of the population," says Levada analyst Boris Dubin. Perhaps sympathy for Khodorkovsky will grow the longer he languishes in Siberia. His sentence ends in 2011. But while he's eligible for parole in 2007, his team isn't optimistic. "I fear that as long as Putin and the people around him are in the Kremlin, there's no chance of Khodorkovsky being released," says his lawyer, Yuri Schmidt.

Even after 2008, when President Vladimir V. Putin is due to retire, most analysts believe Putin will remain a key political figure, with close allies still controlling the Kremlin. "The Kremlin wants to decide who the political leaders will be, and this restricts the democratic process," says Natan Sharansky, the former Soviet dissident who is now an Israeli politician. That doesn't augur well for Khodorkovsky's political aspirations. Still, his supporters hope that public opinion will one day turn against the Kremlin, either because of economic problems or because voters become fed up with authoritarian methods of rule. The former tycoon can't run for office from prison, but he's only 42 years old, and Russian politics are always unpredictable. Three years ago few would have guessed that the country's richest man would now be sewing mailbags in a Siberian jail cell. ■

–By Jason Bush in Moscow, with Neal Sandler in Jerusalem

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Equity Income Fund	★★★★	**12.08%**	**7.39%**	**10.88%**
Personal Strategy Growth Fund	★★★★★	**15.30%**	**5.29%**	**10.06%**
Value Fund	★★★★	**13.70%**	**7.58%**	**11.87%**

Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or loss when you sell your shares. To obtain the most recent month-end performance, call us or visit our Web site. Request a prospectus or a briefer profile; each includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing. All mutual funds are subject to market risk, including possible loss of principal.

The Overall Morningstar Rating™ is derived from a weighted average of the performance figures associated with a fund's 3-, 5-, and 10-year (if applicable) Morningstar Rating™ metrics. Capital Appreciation was rated among 693, 693, 518, and 218 moderate allocation funds; Equity Income and Value among 851, 851, 569, and 268 large value funds; and Personal Strategy Growth among 1,227; 1,227; 931; and 321 large blend funds for the overall rating and the 3-, 5-, and 10-year (if applicable) periods ended 9/30/05, respectively.

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NEW TECH: The Look of Tomorrow's Cars and Trucks

The polls confirm it: U.S. consumers like technology in their cars. So this fall automakers are serving up a big helping of gizmos under the hood, behind the dashboard, and inside the cockpit. Some will help keep you safer. Others will boost fuel economy. Still others simply make the motoring experience more comfortable and convenient.

Most American drivers are intrigued by new technologies. But cost plays a big role in shaping which features buyers actually choose.

For example, at least two-thirds of Americans list run-flat tires, night vision systems, vehicle stability controls, and sensors that detect objects in the driver's "blind spot" as today's most attractive new technologies in the 2005 U.S. Automotive Emerging Technologies Study by J.D. Power and Associates.

But throw in price, and the order changes dramatically. Night vision drops from second place to 17th when consumers find out the feature costs about $1,500. Likewise, navigation systems—also about $1,500—tumble from 8th to 18th.

When price is included in the equation, this year's favorite emerging technologies on the J.D. Power list are stability control ($300), premium sound systems ($400), high-definition radio ($150), and run-flat tires ($600).

Which features do today's car buyers actually choose? Side-impact airbags are a top seller, with four out of five shoppers saying they want that technology in their new vehicle, according to J.D. Power and Associates' 2005 Feature Contenting Report. And nearly 40% of buyers say they want satellite radio. Other popular equipment includes antilock brakes and split fold-down seats.

Hybrids and Fuel Economy

Option price isn't everything, of course. Consider the booming interest in hybrids. These vehicles—which add an electric motor and self-charging battery system to the usual piston engine—carry a price premium of $5,000 or more. It takes years to pay off that investment in the form of better fuel economy. (Best results occur in city driving; fuel savings are less impressive on the highway.)

How popular will hybrids become? Today they command only about 0.5% of all U.S. vehicle sales—roughly 200,000 units. But analysts figure the ratio will grow to at least 11% by 2012 as the number of hybrid models quadruples. Sport utility vehicles and midsize cars are expected to become the market's most "hybridized" segments.

Safety

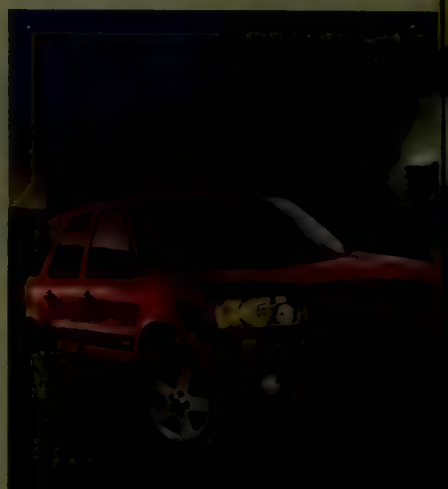
Most vehicles come with antilock brakes already. "Smart" airbags that know when and how powerfully to inflate depending upon the occupant in front of them are taking hold quickly. So are stability control systems that help keep you from skidding or rolling over during sharp maneuvers.

Coming on strong this year and beyond: radar-controlled cruise control and brakes, "steerable" headlights, rearview camera systems, lane departure warning devices, and passenger-side mirrors that tilt down when you back up to help you see the curb.

Comfort and Convenience

Premium surround sound systems are high on the "must-have" lists of today's auto shoppers, according to researchers at J.D. Power. There's also growing interest in cars equipped to wirelessly connect their audio system with the driver's cell phone or make it easy to plug in an iPod or other portable music device.

Author Bill Hampton, who has written about the auto industry for more than 34 years, publishes AutoBeat Daily, *a news digest about activities of the global auto industry.*



2006 FORD ESCAPE HYBRID

INNOVATION AT FORD

This fall Ford Motor Co. declared that innovation—focused upon safety, technology and design—will drive everything the company does from now on. What does that mean for consumers?

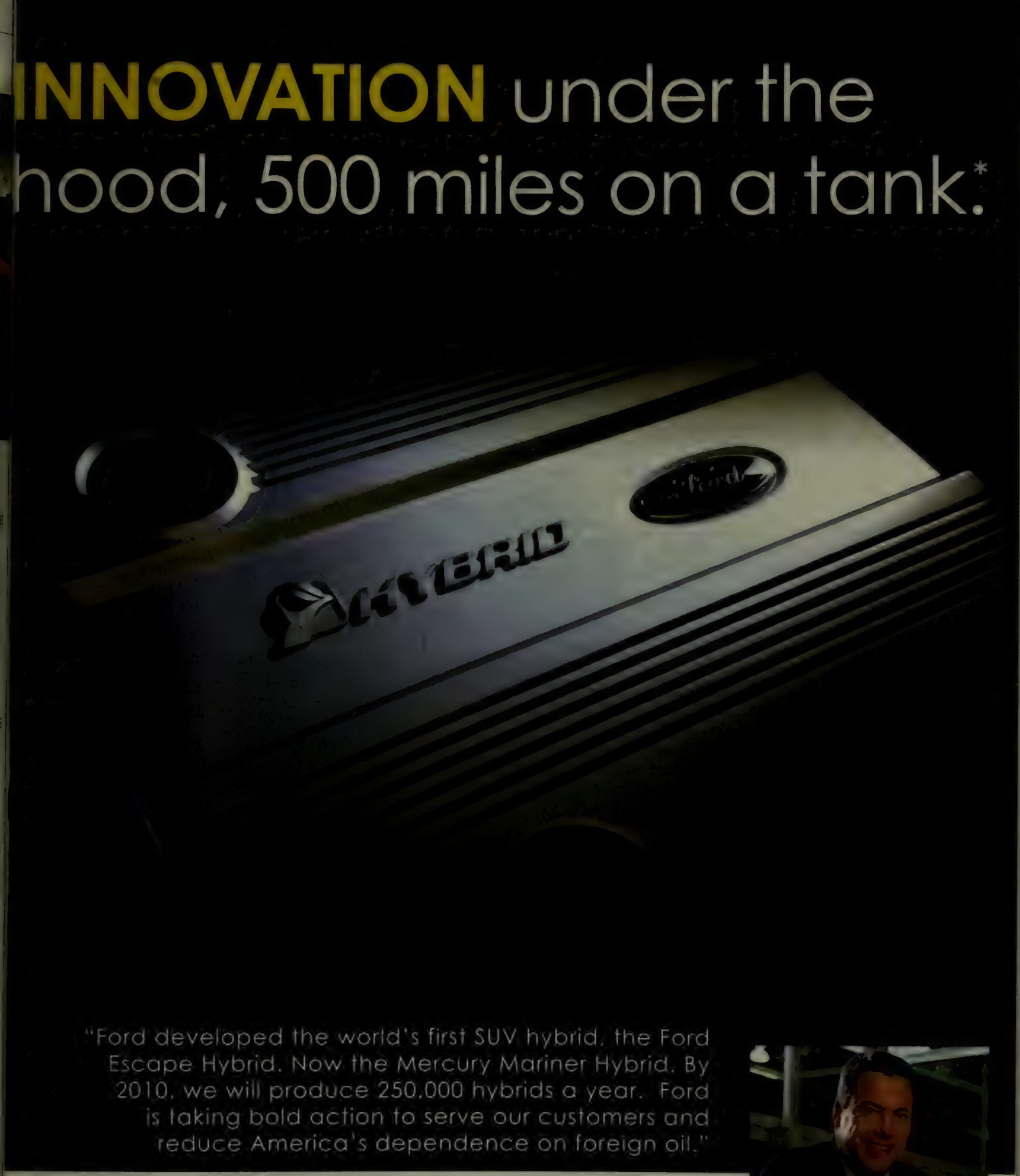
For one thing, consumers will see more vehicles from Ford that save gasoline with hybrid technology or are equipped to run on entirely different fuels such as ethanol.

Last year the company debuted the world's first hybrid SUV, the Escape Hybrid. By 2010, it expects to sell 250,000 hybrid models annually and make the technology optional in up to half the Ford, Lincoln and Mercury brand vehicles it sells.

Ford also is stepping up its "flex-fuel" program—piston-powered vehicles that can run on gasoline, ethanol or any blend of both. For 2006, that option will be available on such models as F-150 pickup trucks and Ford Crown Victoria, Mercury Grand Marquis and Lincoln Town car sedans.

Chairman Bill Ford Jr. also vows to keep the company at the leading edge of safety innovation. Achievements to date include the BlockerBeam, a device that makes bumpers on large SUVs more compatible with those of passenger cars; Safety Canopy, a system of front-to-back side curtain air bags that cushion occupants in rollover accidents; and Roll Stability Control, an anti-rollover technology Ford describes as the the world's most sophisticated.

INNOVATION under the hood, 500 miles on a tank.*



"Ford developed the world's first SUV hybrid, the Ford Escape Hybrid. Now the Mercury Mariner Hybrid. By 2010, we will produce 250,000 hybrids a year. Ford is taking bold action to serve our customers and reduce America's dependence on foreign oil."

Ford

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Bill Ford
Chairman and CEO
Ford Motor Company

*Escape Hybrid EPA estimated 36 city/31 hwy mpg, front-wheel drive, 15 gallon fuel tank.
Your actual mileage will vary depending upon your driving habits. © 2005, Ford Motor Company

Computer Associates: Clearing a Cloud

How John Swainson is remaking the scandal-plagued company

BY STEVE HAMM

JUST ONE MONTH AFTER John A. Swainson joined troubled software maker Computer Associates International Inc. last November, he found out what a mess he was in. He was summoned to a windowless room in the Manhattan offices of AXA Insurance. Across the table sat one unhappy customer: Leon Billis, head of AXA's technology department. Billis, with several serious complaints, said he was considering dumping CA. "It was an awful meeting," recalls Swainson. "You have just taken over a company, and one of your top customers is considering kicking you out."

It only got worse. As Swainson settled into his new CEO job at CA's Islandia campus on New York's Long Island, he got one piece of bad news after another. Products were late and sloppy. He had to fire executives for breaking the rules. Accountants poring over the books kept turning up past mistakes. And all of this came after a group of newly hired execs had been working for months to clean up the wreckage left by the former regime. In June, Sanjay Kumar, the former CEO, was slapped with a fresh round of fraud charges related to the accounting scandal that had rocked CA. His trial, in which he has pled not guilty, begins next spring.

Swainson's journey at Computer Associates is a case study of how one chief executive is struggling to pull off a disaster-recovery project. No turnaround is easy, but patching up an outfit that has been beset by scandal is one of the most challenging situations an exec will face. While few will ever have to deal with such an extreme case, the hurdles Swainson

ROBERT NEUBECKER

ces at the $3.5 billion company can pro-
de leadership lessons for any manager.
It's a juggling act. A leader confronting
is kind of turnaround has to deal with
gulators, appease customers, make
ace with Wall Street, boost staff
orale, and fix the core business—all at
e same time. Management experts say
e key steps are getting rid of all the bad
tors, putting strict accounting rules in
ace, and changing the company's repu-
tion with employees, customers, and in-
estors. "You have to fix the business, cul-
re, and image. The more pieces you
ve to fix, the harder it is," says Joseph
. Pastore Jr., professor emeritus at Pace
niversity's Lubin School of Business.

CLEAN BREAK

FTER A YEAR of feeling his way around,
vainson is signaling a clean break with
e past. At the company's customer con-
rence on Nov. 13, he plans to change its
ame—trading Computer Associates for a
mple CA in hopes of dispelling the taint
scandal. He's introducing the compa-
y's first major new products in four years,
nding an innovation drought. And he's
pening a satellite headquarters in Man-
attan. The message for customers and
artners: No need to brave Long Island's
affic jams. We'll accommodate you.

Swainson has the steady disposition
r the job. Before arriving at CA, the 51-
ear-old worked his way up through the
anks at IBM for 26 years—holding key
roduct development and sales jobs.
Then he first arrived at CA, he read books
n turnarounds and consulted with exec-
tives who had done it before, including
dward D. Breen Jr. of Tyco International
td. and Michael D. Capellas of MCI Inc.

The Capellas consultation came at the
Vorld Economic Forum in Davos, Switzer-
nd, last January. Capellas
arned Swainson he'd have
good days and bad days, but
nore bad surprises than good
nes." Also, he advised him to
ommunicate constantly with
mployees, customers, and in-
estors. "You probably think
ou're overcommunicating,
ut you cannot," Capellas re-
alls saying.

SWAINSON Setting IBM-style standards

Swainson already knew
ne of his most important
asks was changing the cul-
ure at CA. His first move was
o send a strong signal to the company's
,500 software programmers: Innovation
natters. During the 1990s, CA added soft-
vare by buying other companies rather
han developing much new stuff itself. It
amassed thousands of products in nearly a dozen markets. Meanwhile, the place was so bureaucratic that one former engineering chief set up a number-dispensing machine outside her office, like at a deli counter. People took a ticket and waited their turn to see her.

Swainson set out to change all that. He spent countless hours during his first few months meeting with small engineering teams in a conference room in the executive suite. Out of that exercise came a new strategy of focusing on three related corporate markets: systems management, security, and data storage management. Swainson's display of interest boosted morale. Most developers had never spoken to executives before. Now they felt like first-class citizens. Also, Swainson invited anyone with an idea or complaint to e-mail him directly, and they took him up on it. "I routinely send John e-mails suggesting new technologies we should be doing, and he replies," says Kouros Esfahany, the leader of a 10-person development team.

But Swainson doesn't coddle his engineers. Early this summer, they were champing at the bit to release their first major upgrade in four years of a product called Unicenter. At a July meeting on the sixth floor of CA headquarters, a dozen engineering managers gave Swainson and other execs what was supposed to be the final presentation before shipping. After a tense meeting, the CEO rendered his verdict: No go. The release didn't measure up to the IBM-style standards he had set. "He said these products need to clear a higher bar," recalls Jeff Clarke, the chief operating officer, who was at the meeting. After a flurry of improvements, Unicenter will launch next week.

Step two for Swainson was reforming the 2,500-person sales force. A new sales management team had cleaned out most of the bad apples, but more needed to be done. CA had traditionally paid salespeople commissions up front, based on the size of the contracts customers signed. It was easiest for them to simply renew old contracts. A new comp plan pays higher commissions for sales of additional products, and commissions are paid over the life of a contract. That pressures salespeople to make sure customers are satisfied.

Before Swainson's arrival, CA had been patching up relationships with customers, but he found a lot more soothing was needed. He has had one-on-one talks with more than 200 customers. His effort is starting to show results. AXA, the insurance company that nearly dropped CA last December, has decided to expand the relationship. Last month, AXA said it would buy more than $7 million worth of new products and services.

Next on Swainson's to-do list is gaining credibility on Wall Street. He's concentrating on cranking out results, though, rather than schmoozing analysts and institutional investors. Last quarter, CA's revenue grew 9%, to $942 million, while net rose to $41 million—up from a $98 million loss the year before. Still, the stock, at 29, is about where it was when he came in.

Investors have reason to be skeptical. CA has promised cleanups and turnarounds for years. Plus, one lingering issue is beyond Swainson's control as chief executive. Two board members, Chairman Lewis S. Ranieri and former Senator Alphonse M. D'Amato (R-N.Y.), are holdovers from the troubled years. Management experts say that in situations like these it's best to make a clean sweep of the board.

A year ago, Swainson naively figured he could turn CA around in a year. But Capellas warned him at Davos that it might take three or four. Swainson is now reconciled to the long grind. "It took a long time for CA to get so screwed up," he says. "It will take a long time to get it unscrewed up, and it will take even longer for people to recognize it." ■

PLAYBOOK: BEST-PRACTICE IDEAS

At companies where scandal is in the mix, turnarounds are especially difficult. Here's how these cases should be handled:

1. **CLEAN HOUSE** Every tainted executive and board member must go. Otherwise, it may be impossible to unearth all the wrongdoing.
2. **SET THE ETHICS BAR HIGH** Publish clear rules. Set up an anonymous e-mail and telephone system for reporting wrongdoing.
3. **FIND THE BOTTOM** Conduct a forensic accounting investigation quickly to find out the true state of the business.
4. **PREACH PATIENCE** Set expectations with investors, customers, and employees, so you can pursue a long-term strategy.
5. **COMMUNICATE** Constantly update employees, investors, and customers. The message: Total transparency.

SMART OPERATOR
More Sunoco outlets are now run by lessees

Sunoco's Sweeter Spot

Why its shares are trading at a premium over those of its peers in oil refining

BY BRIAN HINDO

SELLING GASOLINE IS generally a lousy business—especially at a time when it's hard to pass on the cost of higher prices to Joe and Jane Motorist. In recent years many big players have been reducing their exposure to the gasoline business.

Not Sunoco Inc. The Philadelphia refiner is one of the biggest operators of filling stations in the U.S. Last year it added some 275 locations, bringing its total to around 4,800—mostly in the Northeast and Midwest. Sunoco pulls in almost 50% of its revenue from its retail division, which includes gas stations and related APlus convenience stores. And yet Sunoco shares are trading at a premium to its peers, including refiners Marathon Oil and Valero Energy.

Of course, it is the buoyant refining business that has helped Sunoco vault to the No. 18 spot on the BusinessWeek 50 list of top corporate performers. As the fourth quarter began, Sunoco had netted a record $687 million on $24.5 billion in sales. Right now, the retail operation barely contributes to the bottom line—just $5 million in 2005 so far. But the good news in a boom and bust business is that when refining profits slump, gasoline profits rise. "The retail sector adds stability to their earnings," says Tina Vital, a Standard & Poor's equity analyst.

THE BUSINESSWEEK 50 The Best Performers

FILL 'ER UP

THE GAS STATION strategy makes a lot of sense for Sunoco, since it is more susceptible to a margin crunch than many rivals. The company uses mostly light sweet crude, which is generally cheaper to refine than other oils. But light sweet crude is also pricier, which cuts into margins. Heavy sour crude, used by Valero, for example, can be from $10 to $15 per barrel cheaper. Sunoco's answer is to start processing more high-acidic oil, which it says is plentiful in Nigeria and other parts of Africa, and Syncrude, the synthetic substance made from Canada's tar sands. Both are cheaper and would allow Sunoco to boost its margins.

What has impressed analysts most, however, is the shrewd way Sunoco has been bolstering its retail presence. "It's a tough business," admits Robert W. Owens, who runs Sunoco's retail and marketing business. "You need a lot of discipline in how you manage it." So while Sunoco is opening new locations, it is steadily reducing the number of stations it owns directly. Increasingly, its stores are run by lessees or licensed dealers—who take over many of the costs and headaches. That reduces Sunoco's take on sales of Twinkies and cigarettes, but it also means pouring less capital into the business. "I'm not a huge fan" of gas retailing in this industry, says Nicole Decker, a Bear Stearns Cos. analyst. "But I think Sunoco is managing it in an intelligent way."

The business only figures to get tougher, as Wal-Mart Stores Inc. and Costco Wholesale Corp. have started putting pumps in front of stores in selected parts of the country. Costco and Wal-Mart price their gas at or below cost to pull traffic into the stores, says Keith Reid, a senior editor at trade publication *National Petroleum News*. But invading Sunoco's turf in the Northeast has been a challenge: It's tougher to retrofit parking lots for gas pumps in a region that's land scarce, has older infrastructure, and a tougher regulatory environment. Still, two major price warriors are entering the gasoline business. That's good news for drivers, but makes the retail game more complex for Sunoco, especially once the refining profit party winds down. ■

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Financial Planning

5 STEPS TO A SECURE RETIREMENT

Imagine a town where a trip for two to the movies costs $68, gas goes for $6.50 a gallon and dinner at a top-rated restaurant will set you back more than $600. And suppose that, despite the town's outrageous prices, you decide to retire there. How much money would you need?

The question isn't just hypothetical. The "place" it refers to is Anytown, USA, 25 years from today. The prices are merely the result of duplicating the amount by which consumer prices have risen over the past 25 years. Inflation is one of the forces working against you as you save for retirement. Taxes are another. Both are manageable with proper planning and the right financial tools. But simply socking away money each month isn't enough. This report will present five steps investors can take today to build toward a secure and abundant retirement.

1. DON'T SKIP THE PLAN

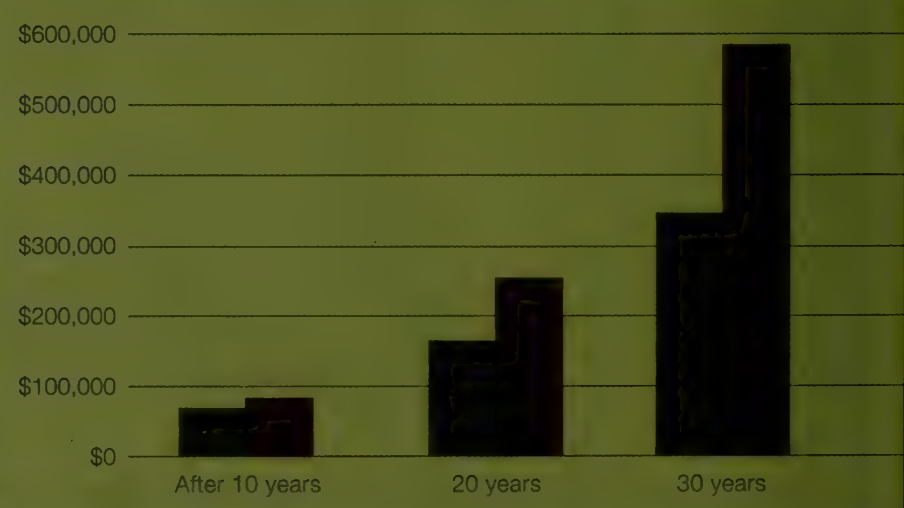
Just four in ten workers say they've tried to calculate how much money they'll need in retirement, according to a recent survey by the Employee Benefits Research Institute. Among workers who have made the effort, 37 percent say they used their own estimates; 10 percent say they simply guessed. That may lead to false expectations — just ask current retirees. Half of those surveyed say that they use 70 percent or more of their preretirement income to fund a retirement that is at least adequate. A majority of today's workforce, though, say they will need less than 70 percent to do the same.

Why are workers so reluctant to perform a retirement calculation, to say nothing of creating a comprehensive financial plan? Many point out that they are already saving what they can. "A plan won't put any more money in my paycheck," goes the argument. But research contradicts that logic. Workers who have financial plans report that they increase their rate of savings, make asset allocation improvements and shift more money into tax-advantaged accounts. They also tend to be more realistic. Workers who do retirement calculations are 50 percent more likely to say they'll need $1 million or more to fund their retirement than workers who haven't done a calculation.

"Too many investors think in terms of 'is the pot getting bigger,'" says Scott Sleyster, executive vice president of retirement services at Prudential Financial. "They don't stop to ask 'is the pot big enough.' The whole focus is on accumulation rather than the level of income that will eventually be needed. If you and your spouse are going to be retired for 30 years, $200,000 is not a lot of money." Indeed, a $200,000 diversified portfolio (25 percent stocks, 40 percent bonds, 35 percent short-term securities) spent down over 30 years might only provide monthly income of about $600.

Tax-Deferred Accounts Build Wealth Faster

Assumptions: Starting balance of $10,000, annual contributions of $4,000, annual return of 8% compounded each year, marginal tax rate of 33%.



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A financial plan can identify potential shortcomings in your current savings strategy, and show you how to address them. Simply saving more money isn't always the answer. By shifting funds to tax-sheltered accounts and improving your asset allocation — more on both of these in a moment — you may be able to accumulate more money for retirement without changing your rate of savings today.

Investors who create financial plans tend to save more, and invest more wisely.

The best place to start is with a professional financial advisor. More workers cite advisors as their most useful resource in saving for retirement than any other information source, including books, Internet sites, classes and family advice, according to the Employee Benefits Research Institute. A good advisor can help you prepare not only to fund your retirement, but also to pay for a child's education, protect against unforeseen hardships and pass wealth on without losing too much to estate taxes (see sidebar).

2. START TODAY

How much do you have to put away each day to accumulate $1 million? Assume that your money grows tax-deferred at a rate of 10 percent annually — about what stocks have returned over long time periods. The answer, of course, depends on how long you have to save. The difference between starting early and starting late may surprise you. An investor with 40 years left before retirement needs to save just over $6 a day to make it to $1 million. For those with 30, 20 and 10 years to go, the daily savings amount increases to $17, $48 and $172, respectively.

In this example, starting twice as early doesn't make things merely twice as easy; it makes them between four and eight times as easy. If you're a late starter, don't despair. You're not alone; more than half of workers say they have less than $25,000 in savings. And 44 percent of Americans age 55 or older have saved less than $100,000.

Overspending may be largely to blame. Half of Americans carry credit card debt; the average balance is more than $8,000. And about half of workers who are asked why they're behind schedule in their retirement savings cite day-to-day expenses as a major factor — more than childcare (cited by 39 percent), home expenses (27 percent) and tuition bills (22 percent). In other words, it's not life's major expenses that seem to be setting people behind. It's the little things; in the average week, two-thirds of workers say they eat out or order takeout at least once, six in 10 buy soft drinks and snacks from a convenience store — 12 percent even buy lottery tickets.

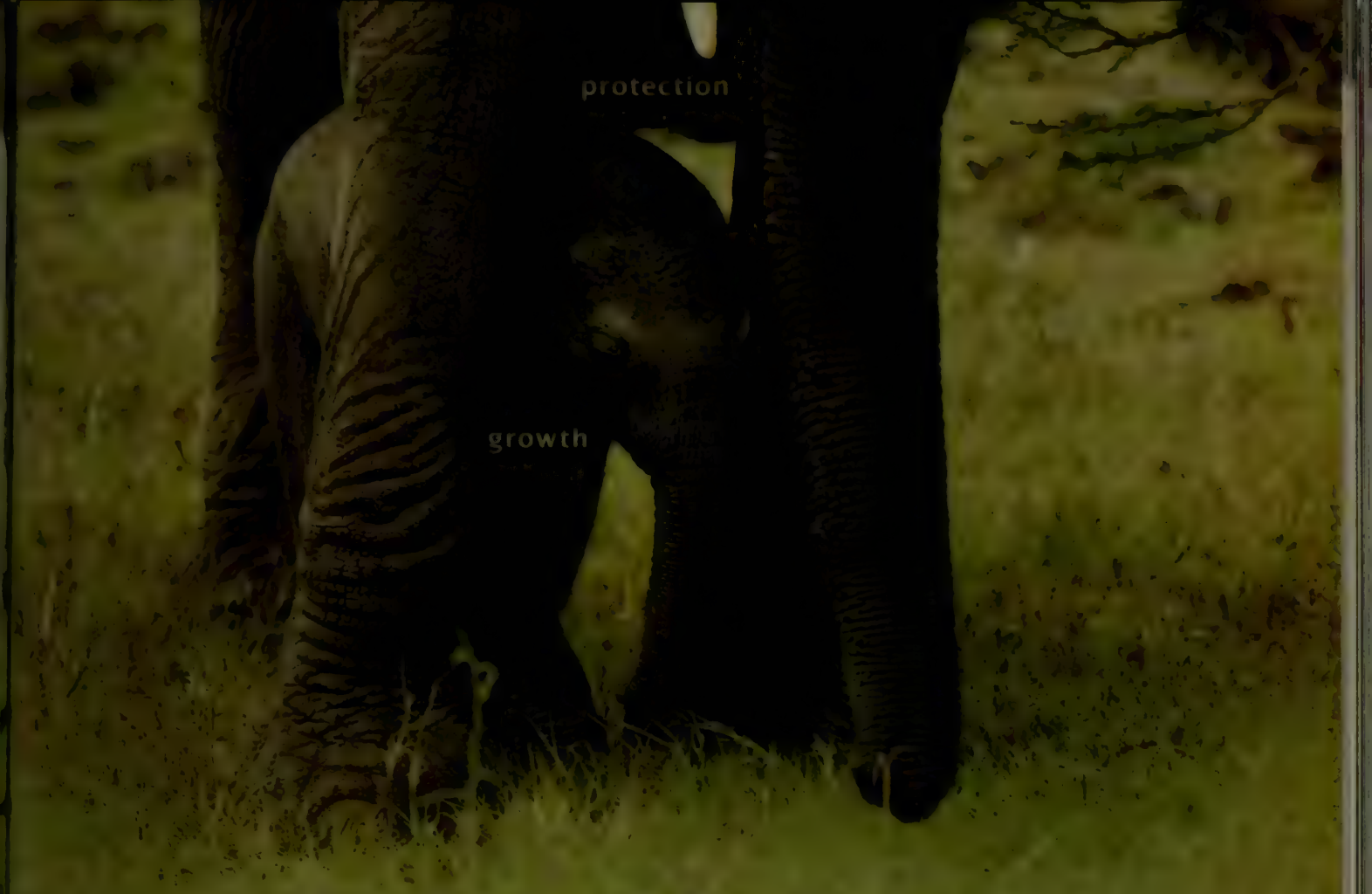
One author coined the term "latte factor" to refer to the few dollars a day that investors can carve out of their spending in order to fund their retirement savings. As we've seen, the earlier one starts, the fewer "lattes" they'll have to do without,

Save Your Heirs a Fortune

The U.S. government's debt right now works out to more than three times the amount it receives each year from taxes. America went further into debt last year alone by the equivalent of more than two months' worth of tax receipts. What does our national indebtedness have to do with the taxes your heirs will pay? Plenty.

In 2004 the estate-tax exemption for individuals (the amount they can receive tax-free) jumped to $1.5 million from $1 million. It's scheduled to rise to $3.5 million by 2009, and in 2010 the estate tax is scheduled to fade away altogether. But estate-planning experts have their doubts about that actually happening, even for one year, given the fickle nature of Congress and the steep aforementioned debt. One common guess — and it's just a guess — is that Congress will install a fixed, more generous, exemption limit starting in 2010, perhaps in the $3 million to $5 million range.

Don't assume that these high dollar amounts don't pertain to you. Estate taxes are levied on your home, land, cars, investment accounts (including retirement accounts), insurance contracts that you own, businesses and more. Marginal rates for estates valued at $1.5 million or more in 2005 start at 43 percent, and run as high as 48 percent. A financial advisor can show you how to use tools like specialized trusts and life insurance to make sure that your loved ones end up the beneficiaries of the wealth you build, not the government.



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all things equal. If you haven't yet started saving, but you've calculated the amount you'll need in retirement and the amount you have to save today to get there, your next step is to create a household budget. Track your spending each week, and look for relatively painless cost cuts you can make.

You'll have to decide what type of investments to buy with the money you save: stocks, bonds, mutual funds, CDs and so on. But before you do that you should choose the best type of retirement account in which to hold these investments. They're not nearly all equal.

3. PRIORITIZE YOUR ACCOUNT CHOICES

Taxes and inflation are two of the main forces trying to keep you from reaching your retirement goals. But there are ways both to fight taxes through tax-advantaged accounts and fight inflation through smart investment choices. Most people are aware of the benefits of tax-deferred retirement accounts. They allow for so-called triple compounding; money earns a return, plus the added return on that return, plus a return on money that might have otherwise gone to pay taxes.

Annuities are gaining popularity among baby boomers who want a guaranteed income stream in retirement.

Consider the case of two investors who start with $10,000, add $4,000 a year and earn a 10 percent annual return. One saves the money in a regular investment account and subtracts each year for taxes. The other saves in a tax-deferred IRA. Both have a marginal federal tax rate of 33 percent. After 30 years the investor with the taxable account will have about $452,000. But the one with the tax-deferred account will have nearly twice as much — more than $898,000.

Thankfully, there are plenty of choices for tax-deferred savings. A financial advisor can help you choose one that's right for you. If you work for an employer who offers a 401(k), you should probably start there. Many employers will match part of your contributions. That's essentially free money. Meanwhile, your contributions reduce your current income, and thus, your current taxes. If you're contributing the maximum to a 401(k) — $14,000 in 2005 — consider putting up to $4,000 in an IRA (see sidebar). Annuities may be the most versatile of retirement savings tools. They're ideal for investors who want tax-deferred savings, growth potential and survivor benefits in one investment (see sidebar).

Note that different account choices are available for self-employed individuals and certain types of workers — teachers, government employees and so on. Also, there are special situations that aren't covered here. That's why it's best to start with step one: See a financial planner who can help you choose the accounts that are right for you.

4. CHOOSE THE RIGHT MIX OF INVESTMENTS

No matter which account you choose, you'll have the same basic investment classes available to you: stocks, bonds and short-term investments like money markets, or pooled investments like mutual funds that hold some combination of these. Experts say that many people are too conservative with their investment choices, because the concept of risk hasn't been properly explained to them. Most of us know that stocks have produced higher returns than bonds and savings accounts over the long term, but that the value of stocks fluctuates from year to year. Many investors, then, assume that savings accounts and money markets are the safest choices they

Roth or Traditional — Which IRA is Best?

In 1998 investors gained a powerful new tool for retirement investing: the Roth IRA. Unlike traditional IRA contributions, Roth contributions aren't deductible, regardless of income level. (Traditional IRAs offer deductions that are phased out in 2005 for individuals who make $50,000 to $60,000 a year, and married couples that make $67,000 to $80,000 a year.) But the Roth offers a sizable benefit in retirement: tax-free distributions.

Both IRAs are limited to contributions of $4,000 this year and next. Which should you choose? Many advisors say that unless you expect to be in a much lower tax bracket in retirement than you're in now, you should choose a Roth. The tax you will save in retirement will more than make up for the lack of deductions today. Roth IRA eligibility phases out at income levels of $95,000 to $110,000 for individuals and $150,000 to $160,000 for married couples, so you'll have to choose a traditional IRA if you make more.

The Swiss Army Knife of Retirement Planning

Among the most versatile of investments, annuities can provide a tax-deferred savings plan or turn a lump sum into a guaranteed income stream. Contributions can be as large as you like. Some annuities provide the growth potential of mutual funds, while others offer fixed rates of return. Many offer survivor benefits that can be locked in and even ratcheted up as the annuity grows. Some can provide lifetime income streams for the holder and for a beneficiary.

Demand for them is as high as ever. "Because more people need annuity-type incomes for long retirements, annuities have become more popular, and more affordable," says Chris Conway, vice president of retirement planning for TD Waterhouse. He notes that, unlike IRA holders who must eventually make mandatory withdrawals, annuity holders can defer withdrawals for as long as they like. "Either draw on annuities, or use them as succession planning tools to pass money on to your heirs," says Conway.

can make, and park all of their funds there. Bad move.

Remember the high prices you will likely have to pay in retirement thanks to inflation? Savings accounts that pay just a few percentage points might not provide enough of a return for you to pull ahead. Just as stocks carry principal risk (the risk that the value of your initial investment will decrease), savings accounts carry inflationary risk, (the risk that the money you end up with won't buy as much).

Most investors saving for retirement should put at least some of their funds in stocks or stock mutual funds, provided they have enough time to wait. Here's why: Since World War II stock returns have been positive over one-year periods 78 percent of the time. That's not a safe enough bet if you have just one year to go until you plan to spend the money. But over rolling three-year periods, returns have been positive 94 percent of the time. For five-year periods the percentage is even higher, and there have been no 10-year periods of negative returns in the post-WWII era.

"As part of a balanced investment plan for most people, stocks have an important place," says Burt Shulman, vice president of Equity Research Services for Standard & Poor's. "The first step is to talk to an investment advisor who can get a holistic view of your financial picture." Shulman adds that, while investors typically reduce their stock exposure as they approach and enter retirement, many choose not to eliminate it altogether. A financial advisor can help investors determine the mix of stocks, bonds and cash that's right for them, and can help them further allocate the stock portion of their portfolios between shares of large and small companies.

5. LAST-MINUTE PLANNING TIPS

If you're fiftysomething and underfunded for retirement, don't panic. There are things you can do to make up some of the shortfall. Catch-up contributions are one choice. Workers over age 50 are allowed to contribute an extra $4,000 a year to their 401(k)s in 2005, and an extra $500 to their IRA accounts.

Another choice is to delay retirement, or work part-time after retirement. With Americans living longer, healthier lives many are doing just that. The difference to your savings can be dramatic. An investor who retires at age 65 and works part-time making 40 percent of their previous income can increase their savings by 30 percent over five years. Still another choice is to relocate to a less-expensive state.

While finding ways to reduce retirement expenses or to continue earning money in retirement are feasible options, prudent planning today can leave the choice up to you when the time comes. If you haven't done so already, meet with an advisor and make a plan. Then, create a household budget and stick to it. Save money in tax-deferred accounts that will maximize your returns. And, if possible, put a portion of your money in stocks or stock mutual funds to fight inflation. The best time to start is today.

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BusinessWeek online **For the full text of this story, go to www.businessweek.com/extras**

Meet Jason Fried, president of 37signals, who thinks that less is more with startups.

Check out six best practices culled from the projects of cutting-edge Web users.

See how Web site digg taps its 80,000 members to unearth interesting tidbits on the Web each day.

APPLE COMPUTER IS WRAPPING Hollywood studios in a big iTunes hug. Blogging mobs are rampaging across the Web. Google seems to be taking over the world—and staking a claim to outer space, too. From news headlines these days, it's easy to conclude that these big names have a corner on Internet innovation. Check that notion at the door.

The Web is wriggling into the nooks and crannies of businesses across the globe, from an Italian electricity giant to an onion farm in Oregon. Some companies are culling data they had never encountered before and sharing the information with customers via blogs or wireless hookups. Others are turning customers into their eyes and ears in the marketplace.

Sure, the technology is zippy. But this year's WebSmart 50 shows that the bigger story, in many cases, is how it redefines age-old relationships. Suppliers are becoming partners, developers are suddenly knee-deep in customer relations, and employees who used to be the last to find out news are publishing it themselves. Such changes are having a far greater impact on companies than anything Google or Apple has cooked up.

Plenty of these projects are about nuts-and-bolts management. But they aren't limited to companies. Schools, public bus systems, even New York City's government are using the Web to reshape operations. Kaiser Permanente's digitization of patient records helped it uncover problems with Vioxx a year before the drug's recall. The American Society for the Prevention of Cruelty to Animals revamped its site on a dime after Hurricane Katrina so it could recruit volunteers for the first time in its 130-year history.

Funny thing: These same Web technologies play a different role in many stories. Even as they convulse entire industries by empowering fleet-footed newcomers, existing companies are quietly employing many of the same innovations to reinvent their operations from the inside. Their efforts rarely make headlines. Nevertheless, these companies are profoundly altering the business landscape. This is their chance to strut.

–By Heather Green

Smart

FIELD WORK Farmer Bob Hall uses Wi-Fi to monitor his crop of red onions

CUSTOMER SERVICE

An Oregon Trailblazer

BY CATHERINE YANG

ABOUT A YEAR AGO, THE 14,000 RESIDENTS OF RURAL Hermiston in eastern Oregon faced a frightening scenario: Nearly four thousand tons of mustard, sarin, and other nerve gases were going to be incinerated just outside of town. Since the Cold War, this remote farming community has been home to one-quarter of the nation's chemical weapons, stored in concrete igloos at the nearby Umatilla Chemical Depot. The Pentagon decided to start destroying those munitions in 2004. Local officials knew they needed to put together a fail-safe emergency plan and stand ready to evacuate the area. But there was one problem: The community had no reliable communications network to call in its 200 would-be rescue workers.

That's when Fred Ziari stepped in. The local entrepreneur, who runs an Internet access provider called EZ Wireless LLC, volunteered to fund and build a wireless network for the three counties around Hermiston. By using Wi-Fi, the same inexpensive wireless broadband technology that people have in their homes, Ziari built a communications network that covers 700 square miles, for about $5 million. It's one of the largest Wi-Fi networks in the U.S. And increasingly businesses, not just local police and volunteer firefighters, are using it. "If we didn't have chemicals in our community, we wouldn't have the Wi-Fi network," says Casey Beard, director of the Morrow County Chemical Stockpile Emergency Preparedness Program. "We're considered fly-over country."

Wi-Fi has become popular as a way to connect computers, printers, and other devices within a 100-foot radius in homes, offices, and Starbucks coffee houses. Now the technology is be-

PLAYBOOK: BEST-PRACTICE IDEAS

GIVE CUSTOMERS CONTROL Let customers manage their own services online. It makes them more satisfied, and it's less work for you.

AUTOMATION ISN'T A DIRTY WORD Done right, automated phone systems and Web sites can zip customers along. Just make sure they help rather than hinder.

DIRECT THE DATA FLOOD The Web lets you gather buckets of data on customers. Use it as a competitive weapon. Or your rivals will.

LISTEN FOR NEW IDEAS Blogs and online bulletin boards are full of chatter. The savviest companies use them to find new ideas and fix things that are going wrong.

g juiced up for wider-scale projects, including those run by ties and counties. That has stirred up opposition from cable nd phone companies in places like Philadelphia. But in Her-iston, as in many rural areas, there is no private-sector rovider of broadband service. So, Ziari's project faced few of e usual speed bumps. Today the network serves as an exam-le of how Wi-Fi can bring high-speed Internet service to re-ote corners of the country at relatively low cost. "If it can be one here, it can be done everywhere," says Ziari.

Local police, firefighters, hospital workers, and port officials re the primary beneficiaries of the new technology. These first esponders pay Ziari fees of $2,500 to $180,000 a year for ac-ess to the network, security applications, and personnel train-g. With a $1 million grant from the Defense Dept., the three cal counties built a cutting-edge emergency response system. sing the network, they can call in first responders, many of em farmers and ranchers who live in the surrounding coun-yside. Each emergency worker is equipped with a laptop with n antenna that connects that person to the network. In the vent of a chemical explosion or spill, that would allow central ommand to give them up-to-the-minute images and data on e path, speed, and composition of, say, a chemical plume. hey could also track rescuers in real time.

Nabbed by the Network

VEN BEFORE Hurricanes Katrina and Rita highlighted prob-ems with evacuations, county officials in eastern Oregon were eploying the wireless network as part of a plan to ensure Her-iston area residents could evacuate in less than two hours. Vi-Fi cameras mounted at 24 critical intersections can monitor raffic. To redirect traffic at a moment's notice, emergency orkers can reset traffic signals, trigger drop-arm barricades to lock off-ramps to thoroughfares, and communicate with driv-rs via electronic message boards—all tied in to and directed via he Web. "This group's evacuation plan is 10 years ahead of veryone else's," says Dan Coulombe, Hermiston's police chief.

The network offers benefits for local businesses. Farmer Bob Hale, one of the SUBWAY sandwich chain's largest sup-liers of red onions, is testing the use of Wi-Fi to monitor rops. Hale takes a laptop into the field to access aerial photos oaded onto his farm's intranet and pinpoint problems with is irrigation systems. Collecting real-time data on soil mois-ure, fertilizer levels, and pest infestations on his 40,000-acre roperty helps him ensure that his plants thrive. "Vegetables re temperamental," he says. "When something needs to be lone, it needs to be done now, not this afternoon and certain-y not tomorrow."

Local police, meantime, aren't waiting for catastrophes to use he network. They shuttle data constantly between headquar-ers and the field, getting reports from police in patrol cars even s they zoom down the highway. That boosts time on the beat. On Oct. 11, Hermiston police officer Leonard Stokoe was parked n his car outside a Wal-Mart store, writing up a report about a urglary at the post office over the weekend to send in wire-essly, when he noticed a gray Pontiac Grand Am. That morn-ng, he had received a call that just such a car had been stolen ocally. He arrested the three passengers and discovered $25,000 worth of checks stolen from the post office. "When we're able to write our police reports out in the community, we can still keep an eye out for bad guys," he says.

Speedy arrests are only one of the many uses of Oregon's Wi-Fi network. Says entrepreneur Ziari: "Like water or electricity, this technology should be available everywhere." ■

PACESETTERS
CUSTOMER SERVICE

Zipcar

Project: Zap busy signals by linking the car sharing service's phone reservation system to its Web site and client databases. Customers are automatically recognized when they call and their requests are routed efficiently.

Payoff: Cut in half the number of calls that needed operator assistance and improved service, contributing $3.5 million to this year's estimated $15 million in sales.

Continental Airlines

Project: Analyze data on the fly to improve customer care. One online system alerts the company when planes arrive late and assesses passengers' needs—delaying departures of other flights or sending carts to make connections easier.

Payoff: After ranking last in the industry for customer satisfaction in the 1990s, Continental climbed into the top tier—ahead of American, United, and US Air.

Museum of Modern Art

Project: As part of its $425 million rebuilding project, the museum's management pumped up the use of technology to cater better to visitors.

Payoff: New services include podcast audio tours, on demand printing of tickets, and a 35-foot flat-panel display featuring art and informational updates on shows and lectures.

Cremation Society of New Hampshire

Project: Buck conventional wisdom by providing information for people researching cremations and let them order the service online.

Payoff: Cremations ordered online are expected to account for about 20% of the company's projected $1.8 million in revenues this year, up from 11% last year.

Enel Telegestore

Project: Install meters for the customers of one of Italy's major electricity utilities and remotely monitor them.

Payoff: Reaped nearly $600 million annually in savings and benefits by recommending shifts in usage from peak to nonpeak hours and slashing field service costs.

BT Group

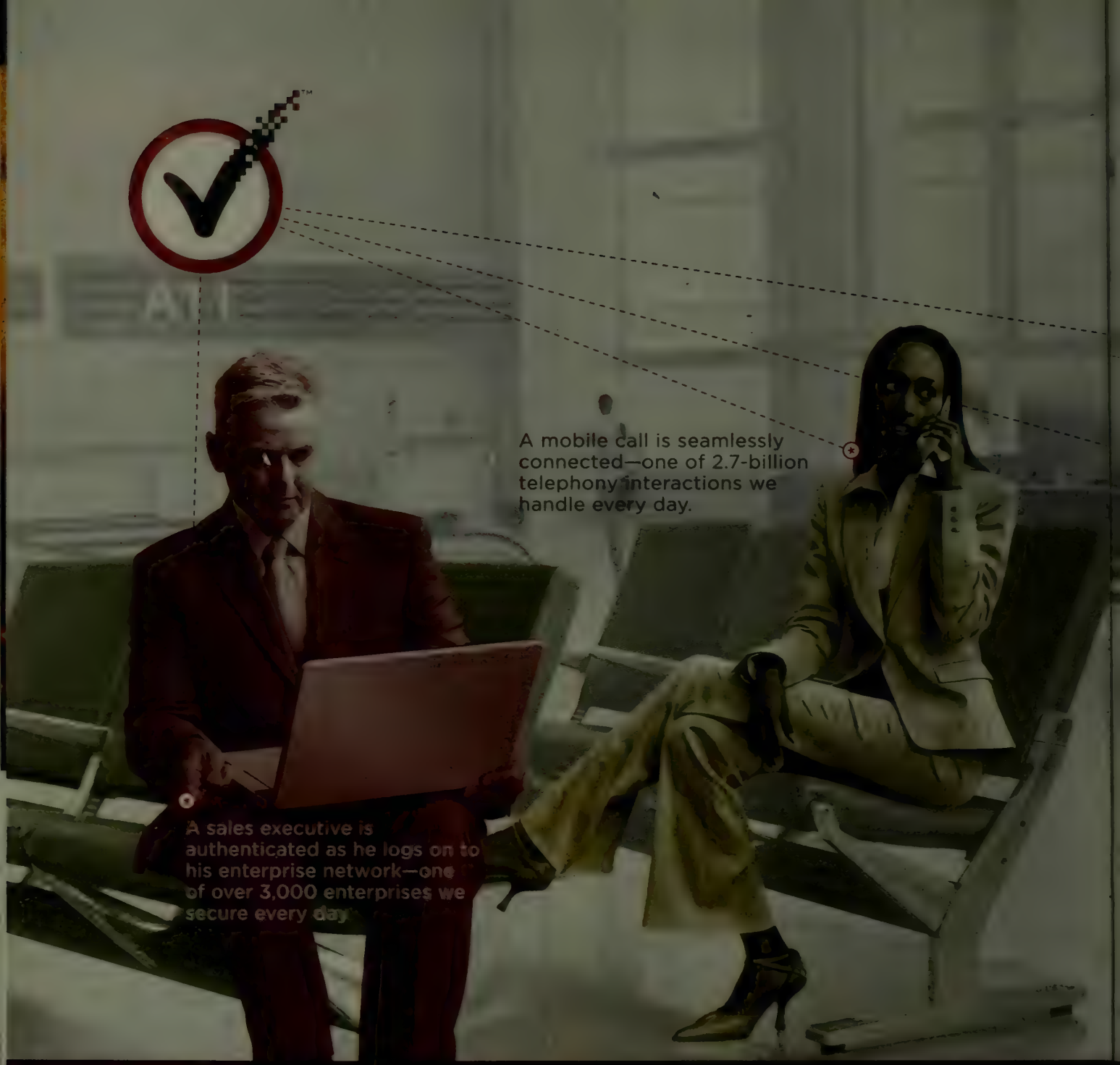
Project: Entirely revamp its self-service Web portal used by customers to manage telecom accounts. Link it to the system used by the company's customer support staff to improve consistency.

Payoff: Customer support transactions done via the Web tripled from 2003 to this year, and half of all new orders for broadband service are made online. Saved tens of millions annually in costs, and boosted customer satisfaction 40%.

Whirlpool

Project: Sign up for Rearden Commerce, an online hub that provides employees at 10 companies with a one-stop shop for services from 130,000 suppliers, including booking travel, shipping packages, and restaurant reservations.

Payoff: During the first phase of the rollout of the shipping service over the past two months, employees saved 10% and cut the time spent arranging for shipping by 52%.



VeriSign intelligent infrastructure at work.

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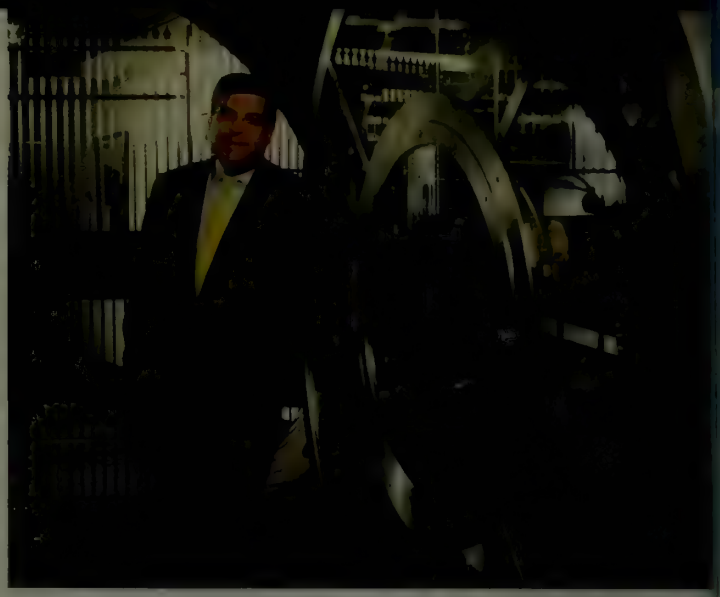
MANAGEMENT

Motivating The Troops

BY STEVE HAMM

THERE ARE UNUSUAL EARLY MORNING GOINGS-ON THESE days at community banks in the college town of Springfield, Mo. Before doors open at branches of UMB Bank, employees gather in a "sales huddle" and listen to managers dole out a mix of praise and exhortation. "It's all about pumping up the troops," says Gil Trout, who runs 25 branches in southeastern Missouri. The huddles seem to make a difference. Trout's branches upped their total retail customers so far this year to 3,800 from 3,500.

That may not seem like a lot in the grand scheme of things, but it's part of a sea change that has swept over UMB Financial Corp. The 92-year-old Kansas City-based bank, with branches in seven midwestern states, had become indolent early in the decade, so new management was brought in to shake things up. Key to this transformation project: electronic management scorecards. They help track the performance of a company, set business-unit goals, stimulate new ideas, and motivate managers and employees to do better. The idea for using huddles came out of a discussion among Trout and his branch managers early this year. Under pressure to meet the quantitative benchmarks of the scorecards, they decided to try the face-to-face huddles, which had been developed earlier by the headquarters staff. "It's becoming part of our culture," says President Peter J. deSilva, who came to the



DESILVA Executive scorecards are "becoming part of our culture"

PACESETTERS MANAGEMENT

Kaiser Permanente

Project: Spend $3 billion on a multiyear project to digitize medical records and manage patient care more effectively.

Payoff: The health-care provider found important data trends. An example: It warned its physicians to stop prescribing Vioxx a year before the pain reliever was pulled from the market.

ASPCA

Project: After Hurricane Katrina the American Society for the Prevention of Cruelty to Animals began getting 800 e-mails and calls a day from people volunteering to help. It overhauled its Web site and database to accept and place people.

Payoff: The group sent about 2,000 volunteers to New Orleans to rescue 7,000 dogs, cats, and other animals and created a list of 24,000 volunteers for future disasters.

IBM

Project: Apply the principles of supply-chain management to people. IBM's goal was to create a database of employee profiles that managers could use to match the right consultant with the right job.

Payoff: With 36,000 consultants in its system, Big Blue saved $500 million in its first year alone, cutting the time needed to assign the employee by as much as two weeks.

DreamWorks Animation SKG

Project: Manage far-flung animated moviemaking through data-sharing and videoconferencing systems that use high-definition displays and digital editing tools to simulate in-person meetings.

Payoff: DreamWorks persuaded comedy star Jerry Seinfeld—who didn't want to travel—to make *Bee Movie*, an animated film featuring his voice and script.

H-E-B

Project: Use online systems at the San Antonio grocery chain's insurer to coordinate the care of chronically ill patients such as diabetics and asthma sufferers.

Payoff: H-E-B cut hospitalization costs of employees in its disease-management plan by 18%. It also identified 7,000 at-risk candidates, where it had known of only 1,200 chronically ill workers before.

Arch Coal

Project: Combine Internet and GPS networking at the company's largest coal-mining operation to create a central dispatching system that monitors and manages major mining equipment.

Payoff: Arch improved the efficiency of its fleet by 15%, saving $3.6 million annually and deferring $9 million in expenses for new trucks.

BP

Project: Boost safety and tracking of hazardous materials by outfitting 240 rail cars in the U.S. with sensors and global-positioning systems (GPS). Send location, status, and other information via satellite to the corporate intranet.

Payoff: After a successful test, the system is being rolled out elsewhere within BP. Software developed with Accenture could be licensed to other companies, generating new revenue.

SUBWAY Restaurants

Project: Equip a 25-restaurant franchise in Arizona with Web phones, broadband networking, and Internet-enabled video cameras.

Payoff: With inventory and sales reports now digitized, workers clocking in using the Web phones, and managers tracking stores remotely, the franchise expects the investment to pay for itself within 14 to 16 months.

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PLAYBOOK: BEST-PRACTICE IDEAS

TRY NEW TOOLS Management is being remade by Web tools, such as dashboards and scorecards. Use them broadly to take full advantage.

USE THE DATA Push for new ways to use data. Leading companies are using data on financial performance, customers, and competitors to grow more efficient and boost revenues.

COLLABORATION IS KEY Teamwork is becoming more important than ever. Foster collaboration with online workspaces, like wikis, which let employees work together from anywhere.

MINE FOR EXPERTISE Pull together profiles of workers online, so there's a central spot to tap in-house expertise or pinpoint job candidates.

bank from Fidelity Investments in Boston 22 months ago. "It's driving behavior, and ultimately, behavior drives performance."

UMB is on the leading edge of one of the hottest trends in technology. CEOs are rapidly adopting electronic scorecards and similar programs to help them better understand and run their companies. Scorecards are sophisticated systems typically used by people at many levels in the company. Viewed through a Web browser, scorecards gather statistics from different databases about inventory, sales, and customer trends. "With these tools, CEOs are able to make better decisions on a more timely basis," says Forrester Research analyst Keith Gile.

Package Deals

UMB's recent financial results have made believers out of some old-school bankers. "I was skeptical at first," says Trout, a 17-year veteran. But when UMB announced earnings on Oct. 25, it seemed as if the company had been taking pep pills. Net income increased 34.7%, to $16.2 million, and loan-interest income was up 37.7%.

The most important move UMB made was tying compensation to scorecard results. In the past the bank paid people based primarily on seniority and cost-of-living adjustments. Now a substantial part of compensation for managers depends on how they perform against scorecard goals. The board of directors reviews results with top executives quarterly, and about 45 second-tier managers get reviewed monthly by the people above them. "If you don't review people and hold them accountable, you won't achieve anything," says deSilva.

One of the key metrics UMB tracks in its scorecard is the average number of its products each retail customer uses. That figure was 2.68 at the beginning of the year, compared with the industry average of 4. The bank's solution was to create bundles of products—such as checking, bill payment, credit card, and overdraft protection—and market them at a discount. It also retrained its customer-service staff. In 10 months the average number of products used per customer has risen to 2.8.

Experts say scorecards should include forward-looking stats instead of just historical data such as quarterly earnings. One example at UMB: the number of customer calls that commercial loan officers make in a month. "I urge my clients to make sure they're analyzing the right data," says John Potter, principal at management consulting firm John Potter Global.

Once UMB has the scorecard process down cold, it plans to deploy a similar technology called dashboards. This Web tool has dials, like a car dashboard, that rise to yellow or red when something goes awry, such as sales falling behind expectations. At that point, UMB employees taking part in sales huddles won't have to find out from their bosses whether they've got something to cheer about. They'll already know. ■

KENNEDY A quick convert to collaborative Web services

COLLABORATION

Teamwork, Supercharged

BY ROBERT D. HOF

I KNEW THIS STORY WAS GOING TO BE FUN AS SOON AS the first message popped up on my new Web site. Assigned to write a story about how one company uses the new collaborative Web services to improve its business, I decided I had to try it out myself. So when Richard Bird, president of the brand identity and design firm R.Bird & Company Inc., offered to help set up an online workspace for me on Basecamp, the collaborative project-management service his firm uses with its clients

Seven years in the business means I know exactly what this job takes – 5 gallons of Slate Mist, 3 guys, 14 hours.

The part I'm not so sure about is taking my business online.

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I jumped at the chance. Within minutes, I posted a request to several Bird clients on my workspace, which they could access with a password, and waited for them to start weighing in.

It didn't take long. One of the first responses came from Chelsea Milling Co., the Chelsea (Mich.)-based maker of those ubiquitous Jiffy brand muffin mixes, which was in the midst of the first major redesign of its cheery blue-and-white product boxes in 35 years. Clearly comfortable with this new collaborative medium, General Manager Jack Kennedy offered a pungent description of the company's plan. "We wanted to look 'refreshed' while maintaining our 'retro-hip' style," he wrote. "You know, sort of like keeping your same girlfriend but with a great makeover!"

A lot of corporations like Chelsea are starting to tap the new collaborative possibilities of the Web. Weary of spam-encrusted e-mail, static intranets, and bloated "groupware" such as Lotus Notes, they're trying out the growing pack of alternatives: group blogs, editable Web sites called wikis, pumped-up Web calendars—and group project management services like Basecamp. The San Francisco market researcher Collaborative Strategies LLC predicts these tools and associated hardware to run them will grow from a $23.4 billion market last year to $40 billion by 2009.

Web-based file sharing slashed the length of Chelsea's redesign

Chelsea's experience with Basecamp illustrates why. Created by the five-person software developer 37signals LLC in Chicago, Basecamp lets groups of people post messages and files, create to-do lists, and set milestones for a project, all on simple, no-frills private Web pages. Items on each page, created by clicking on a button and typing, are listed sensibly in reverse chronology—like a pile of papers on one's desk, but much neater. That's it—no manuals, no arcane commands. Like Google's spartan home page, it's so simple you can't do anything wrong—and so addictively easy to use that one customer calls it "Basecrack."

Like "Next-Door Neighbors"

CHELSEA EXECS HAD their doubts at first. Chief Executive Howard S. "Howdy" Holmes is intensely hands-on, preferring to see photos and even minute retouches in person. Dubious of Bird's promise that Basecamp would substitute for in-person visits, he hesitated to hire a consultant based 650 miles away, in White Plains, N.Y. But R.Bird's design ideas won him over.

The doubts soon dissolved. "It quickly became apparent we could do a lot with the Web," Kennedy says. Instead of hopping a plane every time they wanted to see a new design wrinkle, Chelsea folks could view crystal-clear PDF files of mockups online, often while talking on the phone about tiny alterations they wanted. Such exchanges, which used to take as much as two months, now took minutes.

The service even left room to play pranks. At one point, Holmes took pains to describe a tiny detail of a box design, referring to a piece of a muffin as looking like "a Scotty dog on top of a hockey stick." Afterwards, R.Bird Creative Director Joseph Favata posted a notation in the workspace: "Richard is concerned that the likeness of the BTK killer running down the street with the dagger may cause a drop in sales. (Look at the full muffin while standing on your head with one eye closed.)"

It all paid off. Kennedy estimates that by using projectpath,

PACESETTERS COLLABORATION

Procter & Gamble

Project: Use outside scientific networks for R&D, including the InnoCentive network of 80,000 scientists who work together to tackle research projects.

Payoff: P&G now gets 35% of new products from outside the company, up from 20% four years ago. That has helped boost sales per R&D staffer by 40%.

IJIS Institute

Project: This consortium of tech companies, which supports the Justice Dept., set up a series of blogs to share information among its 16 committees.

Payoff: About 400 people working on 37 projects now collaborate virtually. One committee cut by half the number of phone and in-person meetings it holds.

Intuit

Project: Connect with more tax professionals by creating TaxAlmanac.org, a free wiki, or online workspace, where accountants collaborate to compile tax law resources.

Payoff: Thousands of tax attorneys, professors, and authors have contributed more than 8,000 articles since April.

Linden Lab

Project: Include the 75,000 members of Linden Lab's popular Second Life virtual world in the construction of the 3D online space.

Payoff: Members collectively spend 15,000 hours a day creating objects for the online world. That's the amount of work a 2,700 person team at a conventional game company would bring to a project.

Amber Alert Consortium

Project: Create a portal for the child-abduction notification system, to disseminate alerts faster and get more people involved via cell phones, e-mail, and PDAs.

Payoff: Eight states used the portal to send out alerts this year, rather than relying on television broadcasters and government officials. The approach cuts the time it takes to activate an alert by 75%.

Dresdner Kleinwort Wasserstein

Project: With e-mail proving an inefficient way for workers to collaborate with one another, the financial firm turned to wikis and blogs. These virtual workspaces are used by about 1,500 employees to create, edit, comment, and revise projects in real time.

Payoff: E-mail volume on work projects is down 75%, meeting times have been slashed in half, and team members have become more productive.

Schlumberger

Project: Expand the use of an internal résumé service, originally designed by the engineers at this oil-field services giant to identify in-house expertise when they're struggling on a project.

Payoff: About 32,000 employees in 80 countries use the service on Schlumberger's intranet to share knowlege. Human resource managers depend on the portal to identify in-house talent in a tight labor market.

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as R.Bird calls its in-house version of Basecamp, Chelsea slashed the overall time to complete the massive redesign project from at least two years to about eight months. Says Kennedy: "The Web-based file sharing made it seem like [we] were next-door neighbors." Moreover, says Bird, "Decisions are made more quickly, and I definitely spend less time managing the communications of the project. We can spend more time creating."

Not all the people who work at Bird's clients have made the switch. Instead, they cling to e-mail and the phone—to Bird's clear irritation. "It's 300% more work" for his firm and clients to manage projects without the new technologies, he nearly shouts at me. Problem is, it takes time and practice for people to get used to working differently. "Collaboration isn't something you can just throw over the wall to people," notes David Coleman, managing director of Collaborative Strategies.

Indeed, my adventure into Web collaboration suggests a number of lessons about how organizations can get people to try this stuff: 1) Keep it simple. 2) No, even simpler. 3) No matter how good the collaboration tool, you may have to knock some heads to force people out of old habits. 4) Leave room for what still works: Sometimes, nothing beats a phone call, a face-to-face meeting, or even (gasp) e-mail. But whether it's Basecamp, a wiki, or some other collaboration service, I think I've found one more thing on the Web that I can't live without. ■

STREAMLINING

Doctors Wielding Data

BY TIMOTHY J. MULLANEY

IF YOU TOLD MOST PEOPLE WHEN THEY WALKED INTO A hospital that the care they were going to get would be as strictly regimented as production in a factory, they'd probably turn around and walk out the door. Americans tend to think quality medicine means customized medicine. For care to be good, it has to be tailored just for them.

Brent C. James says people's ideas about health care are all wrong. As vice-president for medical research at nonprofit Intermountain Health Care in Salt Lake City, he's using data and networks to standardize Intermountain's 21 hospitals and 90 clinics. The key: Pore over data on different ways of treating diseases, find the approach that works best, and get every doctor to use it. It's a strategy that's gaining currency in medicine.

Standardization, James says, will mean fewer mistakes, more

PACESETTERS STREAMLINING

NYC Comptroller's Cybersettle Service

Project: Be first city to use the Net to settle personal injury claims more efficiently. Lawyers for both sides submit blind offers until a match is hit. If no agreement is reached after three rounds, it's back to face-to-face negotiation.

Payoff: Saved $17 million since February, 2004, by settling 1,137 claims online out of 7,000 fed into the system. Slashed settlement times to nine months from four years.

Warner TV

Project: Set up a digitalization studio in Los Angeles to centralize the editing and splicing of programming and advertising for 110 local TV station affiliates.

Payoff: Avoided building and staffing remote editing units for the affiliates and cut 90% out of the cost of pulling together programming.

Trinchero Family Estates

Project: The winery, producer of Sutter Hill and other brands, wanted to track the processing of grapes from harvesting to bottling to selling. So it set up an online system, fed by bar codes on everything from barrels of grapes to bottles of wine.

Payoff: Cut the cost of handling raw materials by 3% and avoided spending $100,000 on a system to comply with new bioterrorism rules.

Samsung Electronics

Project: Get a better handle on forecasting demand by creating online links with the systems of hundreds of suppliers and retailers.

Payoff: No more building up inventory to meet potential demand. By aligning sales and production, Samsung cut its days of inventory to about two weeks from 80 days and slashed delivery time to retailers by 5%.

Georgia-Pacific's Harmon Associates

Project: Create an online portal for the decidely untechie market in recycled fibers. The site connects Harmon's 90 traders with suppliers and customers globally.

Payoff: Expected to increase the number of tons Harmon trades to 8 million within five years—a 40% jump worth $230 million in additional revenues.

LG Electronics

Project: Use the existing broadband network in South Korea so employees could make voice calls and hold video conferences at no extra cost.

Payoff: With all employees using Internet phone technology, LG saved some $6.7 million annually, or 50% of the company's former phone bill.

Nibco

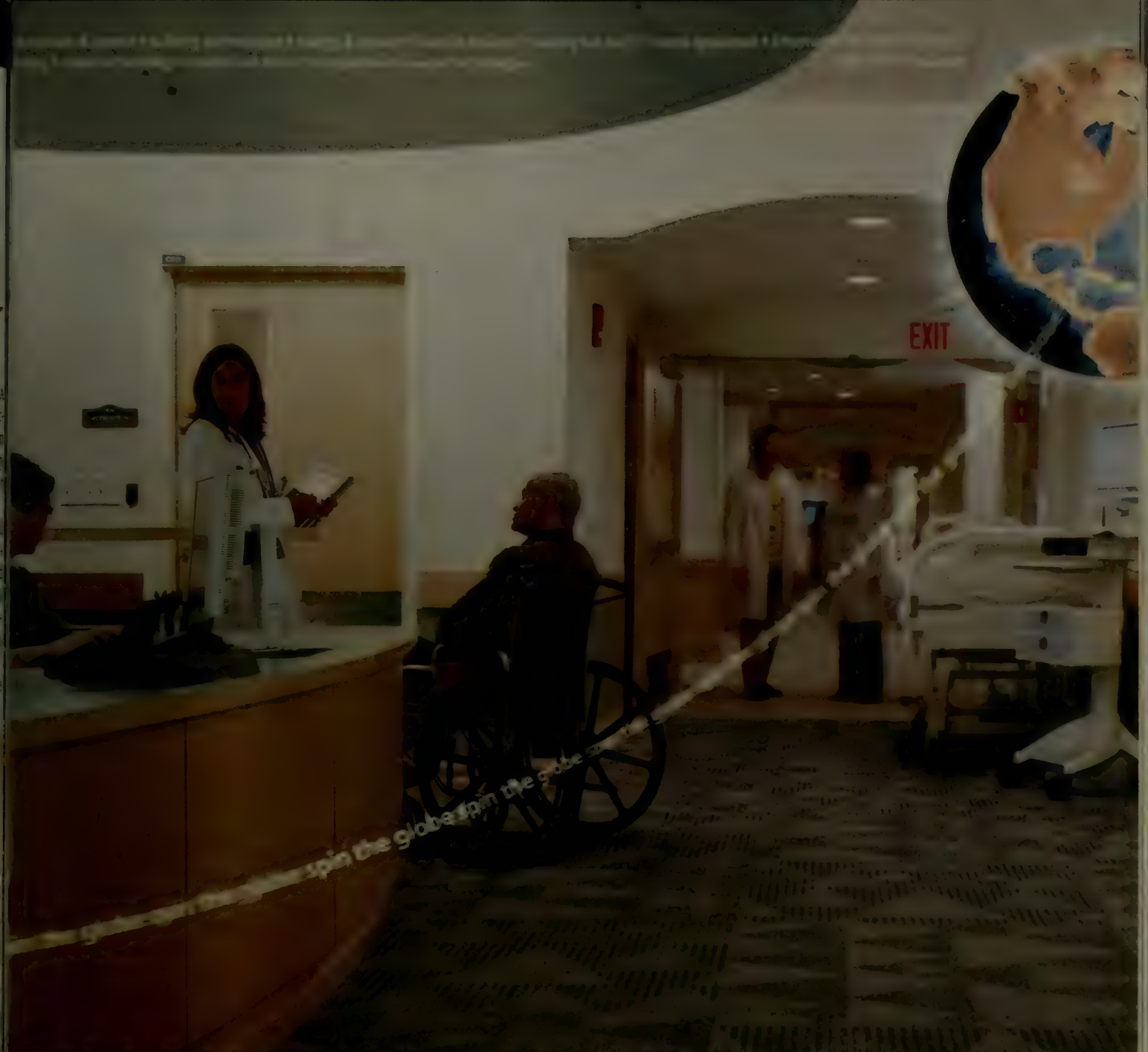
Project: The manufacturer of piping products rolled out new supply-chain technology that allows its 12 plants and distribution systems to automatically share data on inventory, orders, and other key information.

Payoff: With about 70% of orders automated, Nibco has been able to trim inventory by 13% and respond more quickly to changes in orders.

Avnet

Project: Roll out a program that allows 100 globetrotting execs at this tech distributor to make international calls from their laptops with a Web calling system.

Payoff: Eliminate fees from traditional international calls, which can cost as much as a few dollars a minute. Savings? More than a million dollars annually.



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I checked my e-mail after I finished the conference call. I replied to the office back in the States

AND

we raced, my usual run becoming anything but.

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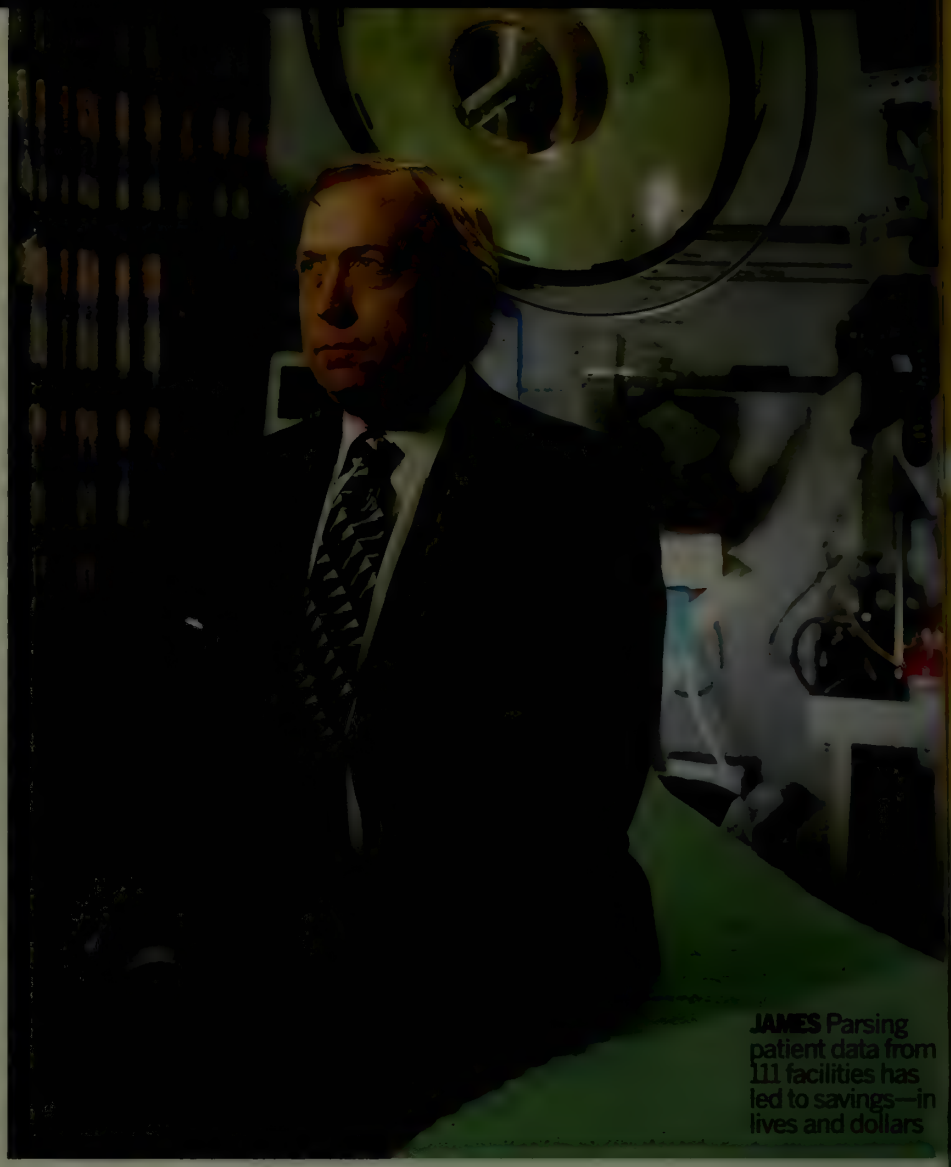
consistent application of the latest research, and lower costs. His belief that a data-driven redesign of care can clean hundreds of billions of dollars in waste out of the $1.9 trillion U.S. system is grounded in Intermountain's results. Its inpatient hospital costs are 27% below the national average, and its operating margins, at 4%, are near the top of the hospital industry. The trade publication *Modern Healthcare* has tapped Intermountain five times as the best-run of the nation's 582 integrated health systems. Intermountain CEO Bill Nelson says: "We may be the only hospital in the country that can demonstrate the business case for using best practices."



JAMES Parsing patient data from 111 facilities has led to savings—in lives and dollars

"Systems Envy"

CERTAINLY, INTERMOUNTAIN is one of America's most tech-savvy health-care organizations. It has poured $106 million into info tech since 2000, helping it make the American Hospital Assn.'s list of the 100 most-wired hospitals and health systems for six straight years. And it's a pioneer in adopting cutting-edge systems, from digital patient records in the 1970s to automated pharmacies beginning in the early '90s. "When I look at Intermountain, I get systems envy," laughs Ivan Seidenberg, chief executive of telecom giant Verizon Communications and a member of a federal commission studying health-care data systems.

The real secret, though, is how Intermountain uses the data from those systems to continually reevaluate and redesign care. Teams of doctors use the electronic medical records of every Intermountain patient to periodically review the approaches the institution takes in treating diseases such as diabetes or heart failure. James's trick: Get doctors involved in the process of coming up with approved ways of treating them, so they won't rebel when asked to use a single therapy. "He's not saying doctors are less important; he's saying that now they are important in new ways," says Harvard Business School assistant professor Richard Bohmer, who co-authored an HBS case study on Intermountain.

Standard treatments don't please everyone, but they're effective

The system's two dozen or so care-process models have made big changes in the administration of drugs and treatment of diseases, including pneumonia and diabetes. A careful study of how Intermountain's LDS Hospital was doling out medication led to changes that slashed so-called adverse drug events to 230 a year, from 570. Since the industry rule of thumb is that 3% to 4% of adverse drug events are fatal, that could save about a dozen lives a year. Changes in how oxygen is administered to critical care patients reduced fatalities by preventing pneumonia, and saved millions of dollars a year. "Brent is showing that when you spend more, you don't necessarily get more," says Megan McAndrew, editor of the *Dartmouth Atlas of Health Care* at Dartmouth Medical School.

Still, Intermountain's approach can be controversial. After data was used to detect a pattern of complications among newborns whose birth was induced before their mothers were 39 weeks pregnant, Intermountain adopted a protocol preventing most early inductions unless medically necessary. Intermountain saves about $500,000 a year and, more important, keeps about 5% of the babies who would arrive early from a stay in neonatal intensive care. But early induction is a popular choice. About 30% of pregnant women nationwide use it.

Still, a big question for health systems eager to mimic this success is whether James's approach will work outside of Intermountain's walls. Plenty of hospitals are trying. But McAndrew argues an important reason for Intermountain's low costs is that the Utah market hasn't been glutted with excess hospital beds, as many other markets have. So it doesn't have the same pressure to fill beds that doctors in other markets may. And unlike most hospitals, Intermountain can standardize care more easily because it employs many of the doctors who practice in its hospitals.

Even James concedes that, up to a point. But there's little doubt that innovations like Intermountain's raise the quality of care. Even if major cost cuts prove elusive, experts believe tech-based reengineering of care is an important way policymakers and private companies can at least better contain health inflation. With insurance prices rising twice as fast as inflation, James's ideas may be coming soon to a hospital near you. ■

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MARKETING

Grabbing the Grassroots

BY DAVID KILEY

WHEN PARAMOUNT PICTURES STARTED PLANNING THE marketing campaign for its hip-hop film *Hustle & Flow* before its release in July, online advertising was a given. After all, 67% of moviegoers these days get information about films online. What was trickier was figuring out where to advertise. High-traffic sites like Yahoo! Inc. and MSN can be pricey and clogged with clutter. Plus, the target audience was young urban males 13 to 24, perhaps not a large part of MSN visitors.

So Paramount decided to take a flyer on a new service from Google Inc. Called site targeting, the service creates specialized networks of what are often small online sites and blogs, the kind of content increasingly soaking up Net surfers' attention. Now this relationship with Google is remaking the way the movie studio and distributor promote every film. And it's among the first examples of how the search engine, through a new service for advertisers, is finally able to bundle the shards and splinters of digital media into manageable packages. The end result is that the smallest Webzines and blogs can better vie with cable networks and magazines for ad dollars.

With *Hustle & Flow*, Paramount had the ideal test case for this kind of advertising. The film is about a Memphis pimp who aspires to be a rap singer, specifically a performer of "crunk," a Dixie-originated hip-hop genre marked by lurching beats and bellowed choruses. *Hustle & Flow* was a blowout hit at the 2004 Sundance Film Festival, but Paramount couldn't count on that industry buzz making it to the grass roots of crunk enthusiasts the movie studio wanted to reach.

Bag the Blog

ENTER GOOGLE. USING key words such as crunk, Memphis and the names of some stars in the movie, Ludacris and Terrence Howard, Google combed through the sites, blogs, and message boards in its network, which it initially assembled by signing up individual sites. For Paramount, Google located around 250 candidates. The studio sifted through those choices, eliminating bawdy sites in favor of music blogs and fan sites. Then it homed in on key markets, including Detroit and Los Angeles, where the movie was being released. In the end, Paramount picked 170 sites, such as Realest Niggas, Atlanta Urban Mix, and uEmcee, that hadn't been on its radar before.

Small turned out to be big for Paramount. Although some of the tinier sites might only attract a thousand or so individual visitors a month, Paramount says the network worked out perfectly. Surveys of people leaving the theater after the movie during the first week found that 35% had been spurred by the Internet to see the flick. So far, the small-budget indie film has grossed $22.2 million. For Amy Powell, vice-president of interactive marketing at the studio, it's all part of coping with the fragmentation of the media landscape. "We reached sites where highly networked Web editors and fans are going," Powell says.

Google's ability to bundle big numbers of small sites based on hobby or passion is a topic of much chatter on Madison Avenue. Google says it developed the service to cater to advertis-

HIP-HOP HIT Google targeted hard-to-reach audiences for *Hustle & Flow*

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The new industry standard x64 servers from Sun.
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[1] One Rack of Sun Fire X4100 Servers populated with Dual-Core AMD Opteron processors can take as much as 56% less power on average than the Intel Xeon MP processor-based server solution required to provide a similar amount of CPU cores.

PLAYBOOK: BEST-PRACTICE IDEAS

OPEN THE DOORS Tap the creativity of the community online. Asking individuals to produce videos or podcasts for ads brings in new ideas.

REACH THE EVANGELISTS From acting to zoology, there are groups of people talking about it online. Connect with the evangelists in your field who can help spread the word.

TRY THE (NEW) NETWORKS Social networking is all the rage. MySpace and other sites can build buzz and reach targeted audiences.

CONNECT, THEN CONTACT Give people a must-have service, such as flight status notification or news on their favorite musician. You can then use that connection to build your brand.

ers clamoring for more control over where their ads were being placed. Unlike Google's AdWords program, where advertisers pay per click, the cost of marketing on the site targeting network is based on a fixed price per thousand ads displayed.

Judging by Paramount's reaction, that's a winning formula. Site targeting is now a standard part of its movie marketing. It followed the same model with last summer's *Four Brothers*, a film that starred Mark Wahlberg. For the sci-fi thriller *Aeon Flux*, which is based on the MTV animated series, it has pieced together a roster of hundreds of sites devoted to comic books and horror films.

More companies are following suit. And step by step, the Net is making it easier for advertisers to go beyond simple demographics and tailor marketing to customers' passions. ■

FRESH FROM THE LAB

How Digg Goes Deep

BY ELIZABETH WOYKE

FIND IT TOUGH TO KEEP TRACK OF ALL THE INTERESTIN information spilling onto the Internet? You're not alone. A much as one terabyte of data is added to the Net each day, re searchers say. That's the equivalent of 50,000 short videos, 25 million magazine stories, or 500 million blog entries. Is ther any way to sort through it all to find what you truly want?

One answer may be found at a little-known San Francisc startup called digg. Founded by Jay Adelson and Kevin Rose the company's Web site pulls together articles, links, and othe info, largely about the tech industry. What's unusual is th method by which content is organized. The company relies o its 80,000 members to unearth the most interesting goodies o the Net each day. It's an early example of the collective strengt of online crowds—and hints at how the sea of online video podcasts, and blog entries could be organized in the future.

PACESETTERS MARKETING

Audi

Project Stage a car theft in New York City to launch its new A3 model, followed by a three-month pursuit with fictional characters at online sites. Stoke the mystery with staged events, as well as magazine, blog, and TV ads.

Payoff More than 500,000 people followed the mystery at any one time online, creating buzz for Audi and over 10,000 leads for Audi dealerships.

Southwest Airlines

Project Develop a service called Ding! that can be downloaded onto a computer desktop. Travelers are alerted to short-term discounts on flights by having a tiny envelope pop up on their screens.

Payoff Racked up more than 1.3 million downloads and more than $50 million in sales since launch in February.

Converse

Project Enlist the public as ad creators by soliciting online 24-second films from anyone with a camera and an idea.

Payoff Garnered 1,600 submissions in one year and more than 40 artful films for TV at a fraction of the usual cost, and increased visits to Converse's site by 80%.

Lego Group

Project Work with train set enthusiasts to develop new products and enlist influential consumers as online evangelists.

Payoff After a new locomotive kit was shown to 250 fans, word of mouth helped the first 10,000 units sell out in less than two weeks—with no money spent on marketing.

Amway Japan

Project Create a mobile e-commerce site that Amway's distributors can tap into via cell phone when visiting customers. That allows them to sell everything from Ramen to Valentine's Day gifts.

Payoff Mobile e-commerce makes up about 15% of sales, key to a company that relies on direct sales and marketing.

Hollywood Undead

Project Use the popular social networking service MySpace to offer up to four original rock/rap songs for free and to communicate with fans.

Payoff The five-month-old band attracted more than 68,000 fans, or "friends," to its MySpace site and saw its songs downloaded over a million times. That popularity helped HU become the first band signed to MySpace's new record label.

Discount Tire

Project The $2 billion retailer of tires and wheels digitized the inventory at its 600 stores, allowing customers to look up products online and laying the groundwork to transfer more advertising to local search.

Payoff Now spends roughly 10% of ad budget on local search ads, up from nearly nothing a year ago, helping the company drum up more business in its local markets.

ROUP THINKERS
igg founders
evin Rose and
ay Adelson

That potential is drawing some high-powered support. A group of investors, including the Omidyar Network, and Netscape Communications Corp. founder Marc L. Andreessen, just invested $2.8 mil-on for a stake in the company. "The more users contribute to e service, the more effective it becomes at identifying the most elevant content. That's very powerful," says Todor Tashev, a di-ector of investments for Omidyar Network, the philanthropic roup of eBay Inc. founder Pierre M. Omidyar and his wife.

How does digg work? Every day its members send in around 00 ideas of things they find interesting. Each is put in an on-ne queue where registered members can vote for their fa-orites. The 15 stories that garner the most votes, or diggs, are utomatically published on the front page of the digg site. The ext most popular stories follow on subsequent pages. Some 00,000 visitors read the site every day, a figure growing by 00,000 per month.

This kind of people power is being used at several places on e Web. The photo site Flickr was one of the early innovators letting Web surfers organize content. It was acquired by ahoo! Inc. earlier this year, and now its technology is being in-orporated in a variety of the giant's offerings. The venerable ech news site, Slashdot, also taps volunteers' expertise. And urrent TV, a startup with backing from former Vice-President l Gore, uses viewer input to organize its video clips.

There are plenty of challenges to the digg approach. It re-uires members who are committed to exploring the far corners f the Net. Plus, you need to be interested in what those partic-lar members are uncovering. "You can surface some really in-eresting results if you have a group of like-minded people," ays Barry Parr, a JupiterResearch media analyst. "The trick is nding a site with which you feel compatible."

Still, digg and sites like it are beginning to work their way round such limitations. The venture money will help digg tai-or its offerings more finely for different audiences. Rose says hat the company is working on making digg "smarter" by ooking at users' past behavior. The founders also plan to move nto categories such as science, politics, and business, and ex-and their popular videocast, diggnation. "The Internet is filled vith all sorts of content: video, audio, games, financial infor-nation," says Adelson. "There are a lot of ways you can apply his concept of collective wisdom to make all that information nore convenient." ■

PACESETTERS
FRESH FROM THE LAB

Metro St. Louis
Project: Put sensors on city buses in St. Louis to send data wirelessly to a monitoring system that predicts equipment failures before they happen.

Payoff: After a five-month trial of 20 buses this year, St. Louis plans to roll out the system to its fleet of 450 buses to help schedule bus maintenance and save fuel.

Rentals.com
Project: Use RSS, the Really Simple Syndication technology popular with blogs, to automatically send alerts to property managers when an apartment hunter contacts Rentals.com.

Payoff: Quicker responses to leads and fewer lost leads in spam-jammed e-mail inboxes.

Lawrence Berkeley Labs
Project: Linking sensor networks that control lighting and air conditioning systems in 35 buildings to a local utility's real-time price data.

Payoff: Automatically changes lighting and air conditioning according to the pricing. That has helped manage costs and reduce demand by as much as 42%.

Salesforce.com
Project: Build an eBay-like marketplace for business applications that run on top of Salesforce's software-as-service computing network.

Payoff: When the exchange launches in December, it's expected to include 100 applications. Companies can subscribe to them—avoiding the headaches of installing software and computers.

San Francisco State University
Project: Create a collaboration system that makes it easy for the commuter university's 30,000 students to work together on projects virtually.

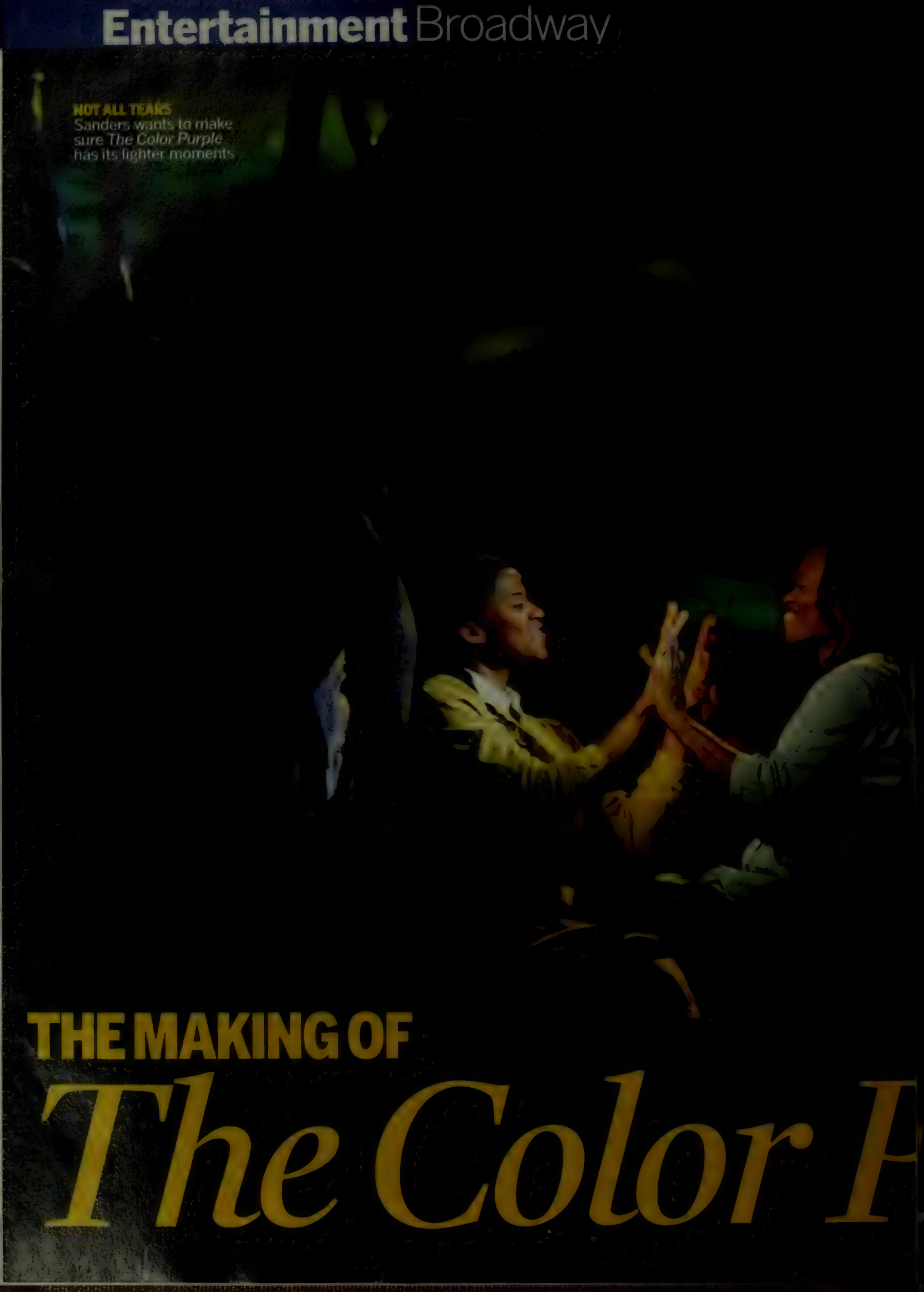
Payoff: When system launches next spring, students should be able to find classmates who are online at, say, 11 p.m., to get help on assignments and collaborate on projects via a virtual work space.

Hackensack University Medical Center
Project: Be the nation's first hospital to implant radio frequency ID (RFID) chips the size of a grain of rice in Alzheimer's and lung disease patients, who might not be able to identify themselves during an emergency.

Payoff: Using the RFID chips and a wand to read them, Hackensack hopes to eliminate medical errors and duplicate medical tests.

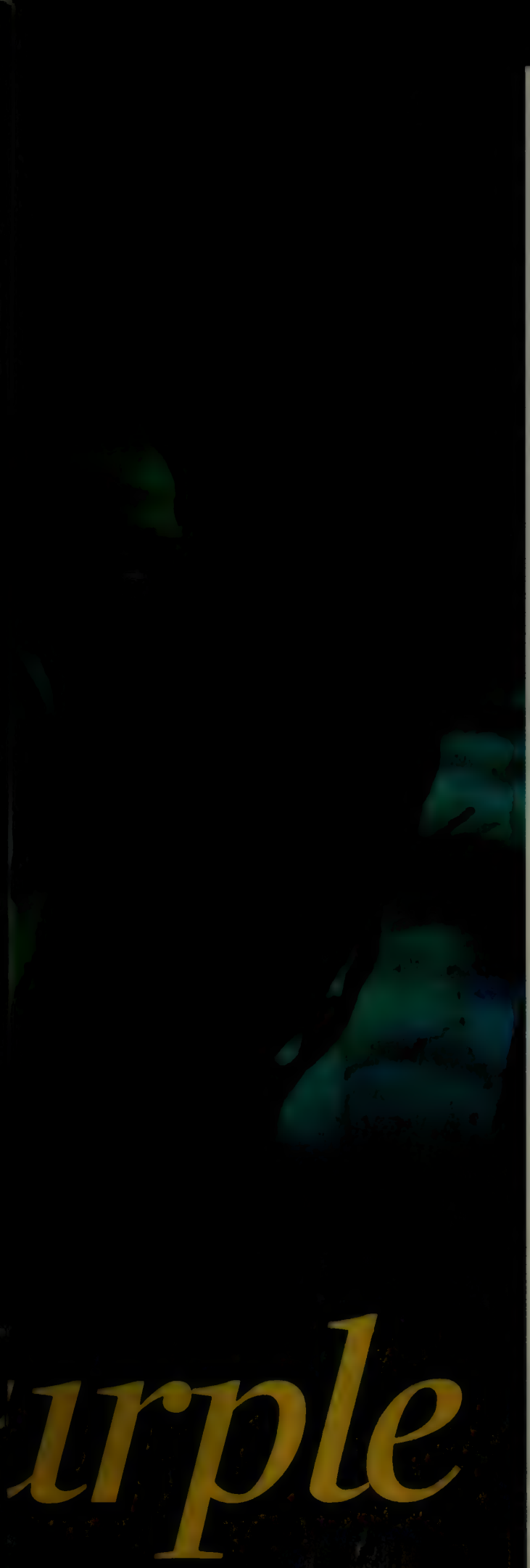
Virgin Music
Project: By yearend, install a huge, 10-ft.-high interactive wall outside a New York store to display images and videos of music, movies, and even apparel. Passersby can touch the screen to learn more about items.

Payoff: Attract crowds. Virgin is considering rolling out walls in other cities, which would let it quickly promote a stream of consistently updated products around the world from one central location through an Internet link.



NOT ALL TEARS
Sanders wants to make sure *The Color Purple* has its lighter moments

THE MAKING OF *The Color P*



Behind the scenes as a masterpiece becomes a musical

BY SUSAN BERFIELD

WHEN SCOTT SANDERS SET out to turn *The Color Purple* into a Broadway musical, he made two critical decisions. He would approach Alice Walker, the author of the Pulitzer Prize-winning 1982 novel, himself to ask for her blessing. But he wouldn't ever appear to be seeking the endorsement of Oprah Winfrey, who had played the sassy, tough Sofia in Steven Spielberg's 1985 movie version of the book and had later declared the experience one of the greatest of her life. With Oprah, you wait for her to come to you.

When Walker did finally agree to entrust her story to Sanders, she wrote a note to Oprah, asking her "to do a little angel work for the show." Oprah never responded. "My letter seemed to fall into empty space," Walker says. That was 1997. In July of this year, Sanders invited Gayle King, Oprah's confidante and editor of her magazine, to a reading of the show; King called Oprah during intermission and said they were doing her proud. But still no word.

Then one Saturday afternoon in late September, six weeks before previews were to begin on Nov. 1, when Sanders had all but given up hope, Oprah called. She asked simply: "How can I help?" To which Sanders, slightly nonplussed, replied: "Coming from you, that's an awesome and intimidating question." Then, as Sanders tells it: "I started to go on and on as I can do. She interrupted me and said, 'Scott, you had me at hello. Just come to Chicago.'"

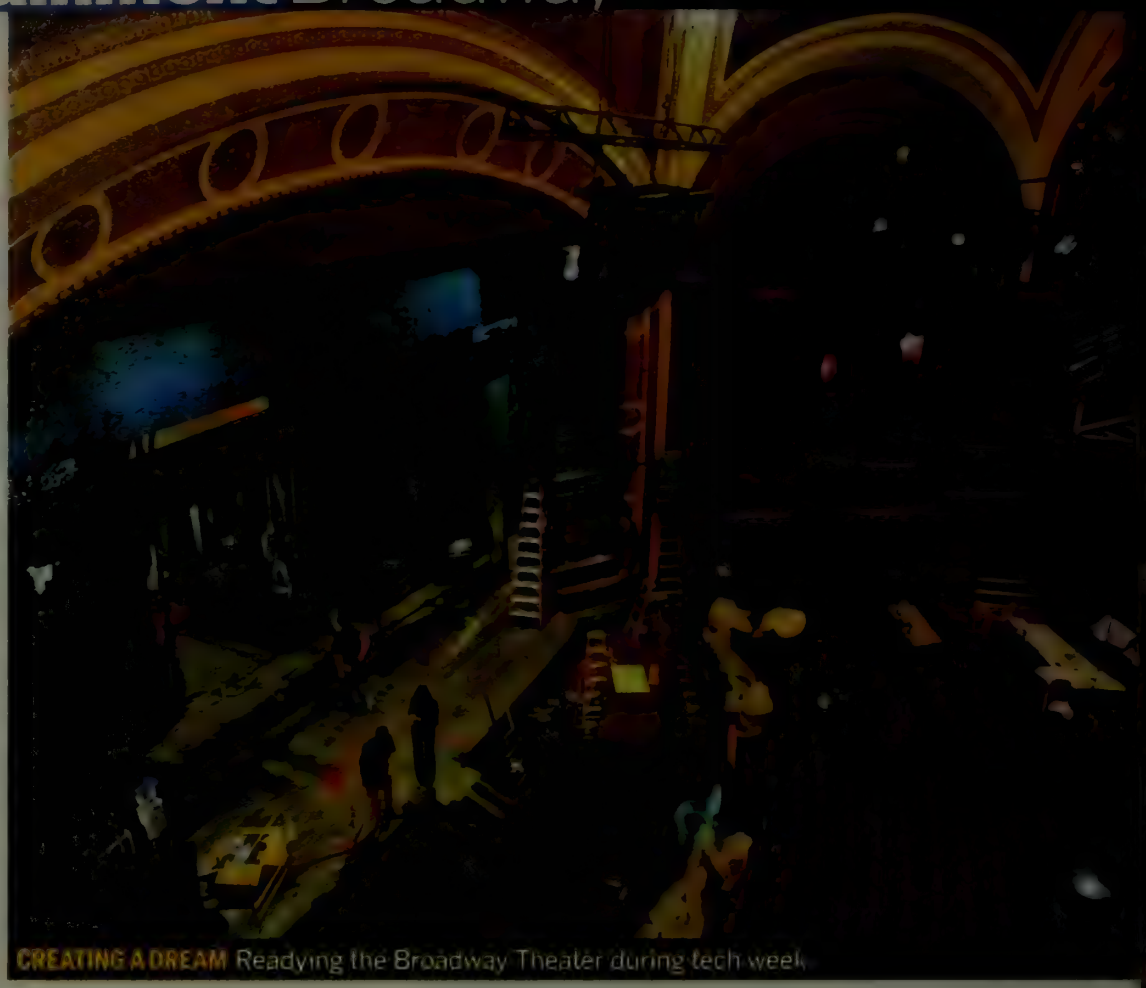
Sanders, two other producers, and his marketing staff arrived at the headquarters of Oprah's Harpo Inc. a few days later. Sanders didn't wait long to tell her how she could really help. "I asked her: 'Can we put 'Oprah Winfrey presents *The Color Purple*' on the marquee?'" She replied: 'You've been working on this for eight years. I don't want to steal your thunder.' I said: 'My name up there doesn't sell two tickets. Your name changes the paradigm.'" And pretty much just like that, everything about the show, from its marketing plan to the prospects for its success, changed. What had been an unusually challenging and highly speculative venture—a serious musical featuring a cast without stars and a creative team who are nearly all making their Broadway debuts—was now merely as risky as any other $11 million show.

Broadway demands much of its producers. Sanders, who is 48 and has never produced a musical before, describes the job as wrestling an octopus, keeping all the puppies in the box, the hardest thing he has ever done, more white-knuckle than he'd like, and the most fun he has ever had. Sanders has to make crucial judgments often at the last minute and always with the knowledge that a single imprudent choice could undermine the

PHOTOGRAPHS BY JENNIFER S. ALTMAN

entire venture. He has to balance artistic considerations with business ones. He has to keep the creative team and investors happy. And he has to keep everybody in sync, even though they work in different places and he has no office with *The Color Purple* on the door. After all that, the company he is running could last for years or fold in a matter of months; it could lose every penny invested in it or generate giant profits. As the saying goes: You can make a killing on Broadway, but you can't make a living.

Broadway plays are handmade products. There are no economies of scale. Every time a musical is performed it costs about $60,000. That's because ever since *Cats* opened in the U.S. in 1982, audiences, two-thirds of whom are visitors to New York, have come to expect elaborate musical productions. What upsets the financial calculus, though, are the natural limits of live theater. In New York, the buildings themselves are all historic landmarks, which means the owners cannot increase the number of seats. Nor can producers add shows to the weekly schedule: Union rules prohibit doing so. "The economics of Broadway are anti-American," says Nancy Coyne, chief executive of Serino Coyne Inc., an advertising and marketing agency that works with producers. "You can't sell unlimited quantities of tickets."



CREATING A DREAM Readying the Broadway Theater during tech week

Art and commerce have never been so closely linked as they are now on Broadway (and, indeed, as they are throughout the world of entertainment). The most pragmatic of producers have started to adopt business practices, such as endorsement and product placement deals, that are common in television shows and movies. The revival of *Sweet Charity* this spring included a line about Gran Centenario tequila; Hilton Hotels Corp. is sponsoring *Chitty Chitty Bang Bang;* and Hormel Foods, which makes Spam, endorsed the musical *Monty Python's Spamalot*.

At the same time, producers are looking for ways to draw more people to Broadway, which sold about $770 million worth of tickets last year. That's where Hollywood comes in again. The deepening cultural exchange between the East and West Coasts is a reflection of the difficult economics of both. Movie studios have come to regard Broadway as an increasingly important place to lengthen the life of their own titles. Many have theatrical divisions, which primarily invest in productions; only Walt Disney Co. produces and finances shows entirely on its own. And while some cringe at the idea of, say, *Legally Blonde* opening on Broadway anytime soon (the producer is aiming for 2007), there are plenty who believe that turning familiar movies into big musicals may be the best way to improve the theater's high rate of financial failure. The harsh reality on Broadway is that four out of five musicals never recoup their investment. Even fewer turn a profit.

WOOING ALICE WALKER Back in 1997, when Sanders was the president of Mandalay Television in Los Angeles, he first started dreaming about venturing out onto Broadway. He had long thought that Celie, the main character in *The Color Purple,* was a remarkable protagonist, one whose emotional and spiritual growth was inspiring. And he believed that the story itself had, as he says, a pedigree: "It is a brand." Unlike nearly everyone else with whom he spoke about the project initially, Sanders was also convinced that *The Color Purple* had "music in it," that the themes of the story—violence, racism, poverty, and ultimately forgiveness, love, and triumph—could be conveyed in song.

The first person Sanders approached with the idea was his boss at Mandalay, Peter Guber, the former head of Sony Pictures Entertainment who just happened to have been the executive producer of the movie *The Color Purple.* Guber called Alice Walker, and one day not too long afterward Sanders visited the author in her brightly painted home in the hills outside Berkeley, Calif., to seek her blessing for the project (he later had to

Why Does A Broadway Ticket Cost $100?

Two answers: More elaborate sets and more expensive advertising. Here's what goes into a typical musical:

*Doesn't include theater owner's percentage, usually 51

AGAIN Rehearsals can be brutal

BRUSHING UP Getting the hair just right

DRESS In the fitting room before the Oct. 31 final run

PUTTING IT TOGETHER Assembling the set at a Yonkers studio

secure the rights to the story from Warner Bros. and Amblin Entertainment). She said to him: "You seem like a very nice man, but I'm not sure I want to do this again." Sanders took that as a maybe. He suggested that she call some of the other women he had worked with over the years, including Diana Ross, Bette Midler, and Shirley MacLaine, who could vouch for his character. Which she did, and which they did.

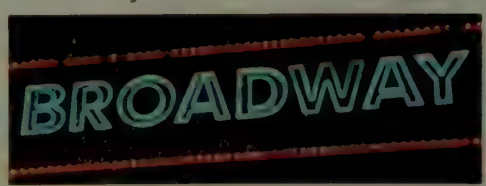
Then he invited Walker to Manhattan, where he took her to several musicals and chartered a yacht for a dinner cruise to introduce her to some of his friends in the theater community. (Before joining Mandalay, Sanders had been the executive producer of Radio City Music Hall for 15 years.) Finally, on the last night of her weeklong visit, when just the two of them were out to dinner, he promised that if she disagreed with any of his creative choices, he would follow her wishes. She gave her consent. As she says now: "I'm always happy to take a risk if it looks like it will be entertaining."

Sanders has intimately involved himself in both the creative and business demands of turning *The Color Purple* into a musical. His ideas are informed by two desires, he says: to fulfill his promise to Walker to maintain the integrity of the characters, whom she calls her ancestors, and to entertain as broad an audience as possible. From the start, he has tried to bring out the joy and sensuality of the story. "There are people who will think that the show isn't dark enough, that there's too much laughter," he says. "That was a deliberate choice. I didn't want people to leave during intermission."

RAISING $11 MILLION When Broadway came into its own a century ago, it was a place of big personalities and grand gestures. Producers in those days were showmen: They funded musicals on their own and did as they pleased. Now a producer usually needs a dozen or so investors to come up with the millions required to bring a musical to the stage. The glamour of the theater, the artistry, the excitement of live

GE TO AGE	$12 MILLION TO GET TO OPENING NIGHT
costumes, lights	$3.8 MIL.
ies and expenses in the re through opening night	2.0 MIL.
ies for creative team, staff	1.6 MIL.
arsal salaries	1.3 MIL.
rtising and promotion	1.0 MIL.
rve	1.0 MIL.
inistrative	700,000
nces for writers, tor, designers	375,000
ing/rehearsal expenses	180,000

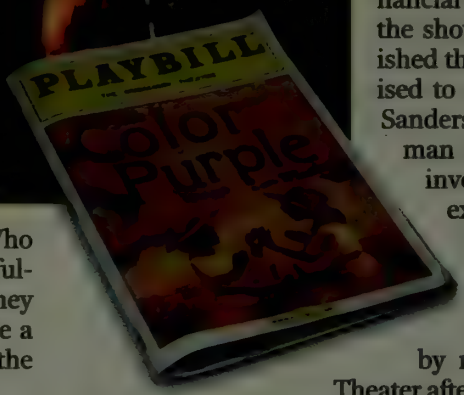
KEEPING THE LIGHTS ON	HALF A MILLION EVERY WEEK
Theater expenses*	$175,000
Salaries	150,000
Advertising	80,000
Maintenance of physical production	65,000
Administrative	25,000
Fees and royalties**	5,000



s earnings ** Doesn't include royalties to the creative team Data: *On Broadway. Art and Commerce on the Great White Way* by Steven Adler

(BOTTOM) BUD FREUND/INDEX STOCK

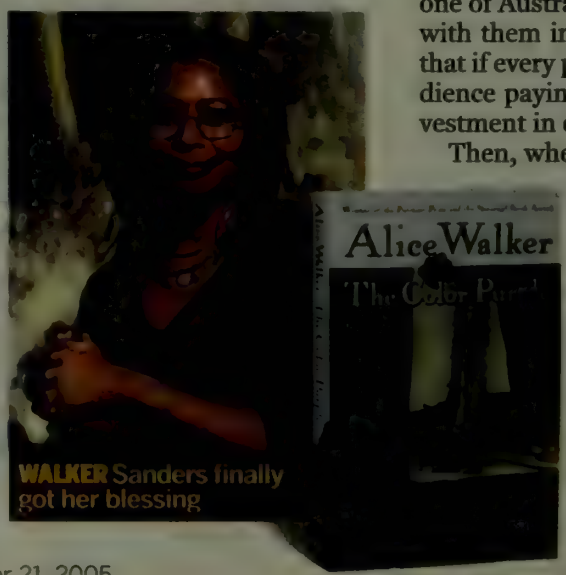
BACKSTAGE Griffin (l) with producer Johnson and Sanders



entertainment, abundant talent, opening night parties: Who wouldn't want to buy into that? But investors must also be fully prepared to lose every penny. In the best of situations, they serve as a board of directors, experienced enough to advise a producer, attentive enough to ask the right questions. In the worst, they behave like demanding relatives.

Sanders wasn't eager for that pressure right from the start. So about four years ago, he made a deal with AEG Live, a division of Phil Anschutz' entertainment business, and the HEAT Group in Miami to create a production company called Creative Battery. The company put $2 million into the show in 2002 and another $2 million or so later; those figures include Sanders' own contributions (he declined to specify his investment). AEG Live, which also helped negotiate a Visa International sponsorship that extends through 2006, is a strategic investor, says president and CEO Randy Phillips, "but I wouldn't stop Scott from pursuing his vision. He's taking a piece of clay and sculpting it. I'm betting on the sculptor." When it comes time to plan *The Color Purple*'s national tour, a critical source of revenue for most Broadway musicals, AEG Live will be in charge, though.

That initial $2 million got *The Color Purple* through its month-long trial run in Atlanta last year. At that point, a reviewer in *Variety* said the musical was missing "a sense of the sweeping poetic scale demanded by both the material and the form," a critique Sanders agreed with. But the show played to sold-out houses and regularly received standing ovations. On opening night, Alice Walker saw it for the first time. As she says now: "I was praying as hard as he was that I liked it." She sat next to Sanders but said nothing afterward; Sanders was so nervous that he sat somewhere else the next night. At a reception later, Walker hugged him and said, "I can stop worrying now."



WALKER Sanders finally got her blessing

There was someone else there whose opinion Sanders was eager to hear: Roy Furman, the Wall Street financier, frequent Broadway investor, and big-time Democratic Party fund-raiser. Years ago, Furman had hired Sanders to produce an event for then-President Bill Clinton, and they had remained friends ever since. Furman says: "I told Scott I was emotionally stirred, but that it needs real work." When Sanders returned to New York, he in turn told Furman that he hoped they could work closely together in both the financial and creative development of the show. Before they had even finished their breakfast, Furman promised to raise half of the $11 million Sanders figured they needed. Furman himself made a seven-figure investment. If Sanders is chief executive, Furman is the president, and as such he has become as familiar a figure as Sanders: attending marketing meetings, dropping by rehearsals at the Broadway Theater after finishing his day job as vice-chairman of Jeffries & Co.

When Furman approached Broadway's traditional investors, though, some were wary of getting involved. *The Color Purple* challenged several long-held beliefs: First, that white audiences won't go to a show with an all-black cast and that African Americans usually don't go to Broadway at all. And second, that at a time when most successful musicals are lighthearted, a show with such serious themes didn't stand a chance. That it was unconventional was precisely what interested Furman in the show. "I told potential investors that it is a challenge," he says. "But the first something to break the rules is always exciting. The next something isn't."

So, as Furman says, there is more non-Broadway money in the show than usual. He won't say too much more than that, but Quincy Jones, who co-produced the movie and is a friend of Furman's, joined as a producer. Film producers Bob and Harvey Weinstein got involved, as did businessman Gary Winnick. Over the summer, Furman got some money from one of Australia's richest families, the Lowys, while traveling with them in the south of France. He and Sanders estimate that if every performance is filled to 75% capacity, with the audience paying full price, *The Color Purple* will recoup its investment in one year.

Then, when the show was already fully capitalized, Oprah called. Furman and Sanders scaled back some individual investments to accommodate Oprah's $1 million or so. Once they made the announcement about her involvement, they "were bombarded with people major and minor who wanted to get in," says Furman. "We told them all no."

TAKING CREATIVE RISKS In putting together his artistic team, Sanders chose to dispense with the received wisdom of the industry: Simply put, hire the big names. That decision, of

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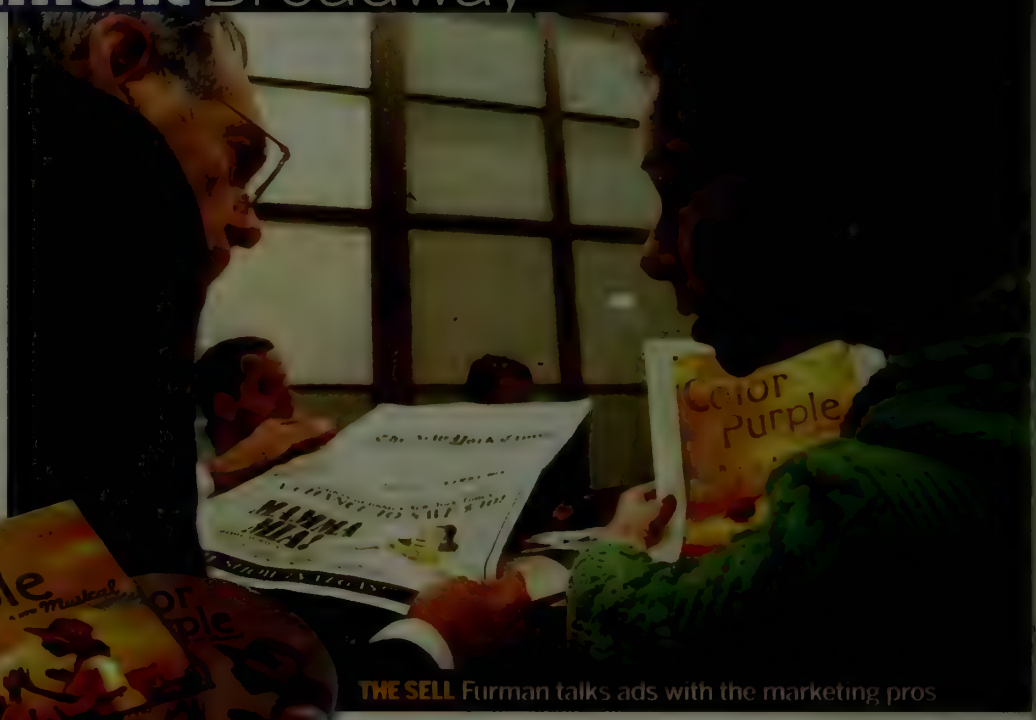
course, has upped the ante. The show's writer, Marsha Norman, won a Pulitzer Prize in 1983 for her play *'night, Mother.* But the director has never been on Broadway before; the three composers come from the world of Los Angeles pop; the choreographer works in modern dance.

When it came to casting, Sanders worried that a recognizable actor, especially one from Hollywood, wouldn't be believable as Celie, whom he describes as a "wounded bird" in the beginning of the story. But Shug Avery, the blues singer whom Celie falls in love with, maybe. There were plenty of famous people who wanted those parts. He resisted, though, because he also came to believe that replacing a celebrity, who would inevitably sign on for a limited run, with someone unknown would put an unnecessary burden on a show that was already taxing enough. Better, he decided, to wait a couple of years into the show's life and then reinvigorate it with a star turn. So he filled the lead roles with actors who, while hugely talented, aren't "the insurance policy" some investors were looking for.

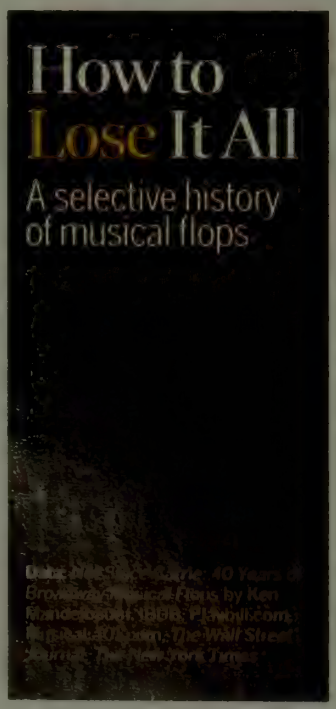
His inspiration in all of this was Thomas C. Schumacher, the head of Disney's theatrical division, who had made the unusual decision to hire an avant-garde director to put *The Lion King* on stage. "I was thinking about who wasn't obvious for the show, but instinctively I knew was right," says Sanders. "Plenty of people said I was crazy not to hire veterans of Broadway. 'If you're going to produce your first $11 million film, why wouldn't you get Martin Scorsese to direct it and Halle Berry to star in it?' When I felt insecure, I reminded myself about Tom."



THE SELL Furman talks ads with the marketing pros

Producers don't always involve themselves in the intricacies of the lyrics, the script, the set, the costumes. When they do, they can easily disrupt the artistic process. As with bosses anywhere, a producer's arrival sometimes signals, however unintentionally, that there is trouble. When faced with this management challenge, Sanders devised a simple solution: He kept showing up. He is around so often that no one freezes up anymore when they see him, says Felicia P. Fields, who plays Sofia. Sanders, she says, "is the man, he signs the check, but you can connect with him." He calls the star of the show, LaChanze, at home on Sunday afternoons to see how she's doing; she says he's the Big Pappa. He spoke to Elisabeth Withers-Mendes, who plays Shug and has never acted before, from an overseas flight to tell her how much he enjoyed her performance in a showcase for her record label. He has taken the writers out for expensive dinners when they needed to unwind, brought a great bottle of tequila to rehearsal when they needed a lift.

Along the way, Sanders eased up a bit as he grew more confident the show would come together. He asked a longtime friend and collaborator, Todd Johnson, who has been involved creatively with the show for four years, to be his liaison with the composers and writers so he could spend more time, as he says, "selling tickets." As Norman sees it: "Scott has learned to watch from the right distance. In the beginning he stated his opinions: 'Like that, hate that.' It shut us down. He has learned he can't tell writers the solution, but he can



ONE OF THE FIRST MUSICALS TO LOSE SERIOUS MONEY

$1 Million *Via Galactica* 1972, 7 performances	
$12 Million *Dance of the Vampires* 2002, 56 Performances	**$10 Million** *Bombay Dreams* 2004, 284 performances
$12 Million *The Mambo Kings* 2005, never ran in N.Y.	**$10 Million** *Seussical* 2000, 198 performances
$11 Million *Capeman* 1998, 68 performances	**$8 Million** *Carrie* 1988, 5 performances
$10 Million *Taboo* 2003, 100 performances	**$6 Million** *Shogun, the Musical* 1990, 72 performances

Note: Performances don't include previews

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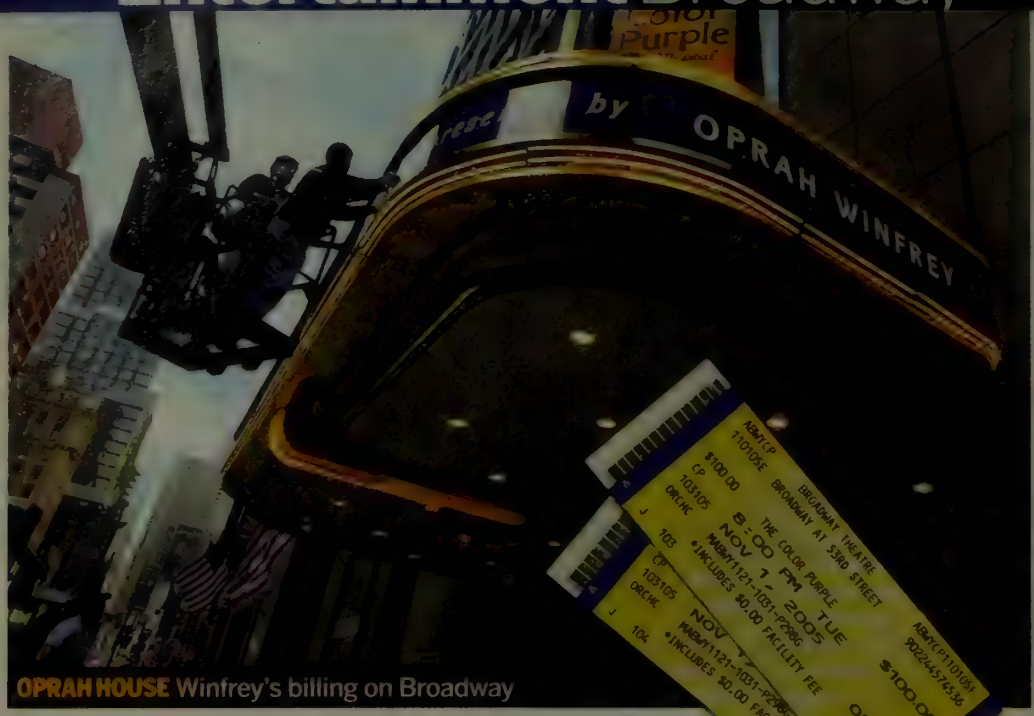

OPRAH HOUSE Winfrey's billing on Broadway

carefully define the problem. Not many producers can do this."

Sanders' approach was on display during a two-hour presentation in July by the set designer, John Lee Beatty, and director, Gary Griffin. This was the first time Sanders was seeing the many changes they had made since Atlanta and he had at least one concern: "Can we have a couple of 'wow' moments, where the audience feels like they're seeing a great Broadway musical?" he asked them. "Gary hates that I'm asking this. As a producer I want those Broadway moments. I just want you to think about it. I'm just throwing out a few ideas. I trust you."

MANAGING THE BRAND From the outset, Sanders recognized the responsibility of dealing with a story that has become a part of African American culture. As he says: "I use the word franchise very respectfully." Oprah's endorsement gives him more credibility.

One important issue that had come up during the summer was who they should approach to record the radio spots that still account for the bulk of Broadway advertising: Some of the staff at SpotCo., the agency Sanders had hired, argued for the traditional, anonymous white male voice of authority. Sanders was interested in an African American female voice. Problem solved.

After Oprah's arrival, the focus at weekly marketing meetings was on how to reach her viewers. The full cast would be singing two numbers on Oprah's show to be aired on Nov. 11. This gave Sanders a chance to convince a bigger audience than he ever could have that the music wasn't, as he says, "dirge-like," that the show wouldn't be depressing. In the early fall he had sent 500,000 direct-mail offers with a three-song CD to frequent theatergoers; now the cast would be singing to as many as 49 million, many of whom rarely see a Broadway show. But none of those present at SpotCo.'s office on Oct. 25 were sure how to gauge Oprah's impact on ticket sales. She can turn a book into a sensation. But a Broadway show is not a book: It's costlier, and for most theatergoers it requires travel. Sanders wanted to follow up the cast's appearance with a special online ticket offer for Oprah's audience. Would she announce the discount on the air? Not with a specific price. Should the offer appear on her Web site or theirs? Hers. Shouldn't there be ads in the suburban papers that week, since Oprah says her viewers don't necessarily read *The New York Times*? Absolutely.

Sanders now gets regular e-mails from Oprah, who told *BusinessWeek* that "being a part of Broadway has always been a secret dream of mine." At first, she had been particularly interested in the recording contract he had sealed with Angel Records, part of EMI Group, to record a cast album as well as two singles by big-name performers. Early on he had asked the composers for two things: an uplifting song that Celie could sing on, say, *The Today Show*; and a pop ballad for Celie and Shug that he could conceivably get on radio. He had gone back and forth with them about whether this was a good idea in a score of mostly gospel, jazz, and blues. Sanders decided it was, and recently he signed Patti LaBelle and Jill Scott to record the ballad. The second song Angel is interested in is *The Color Purple* itself, and Oprah, he says, is very keen to find the right artists for that.

Sanders is eager for Oprah's opinions about more than the marketing of the show, though. He asked her to come to New York for a preview, and on Friday, Nov. 4, she did. She walked through the front door five minutes before the curtain rose, surrounded by a six-person coterie, as the audience "went insane," Sanders says. After the show, they repaired to her suite at The Four Seasons, took off their shoes, drank champagne, and talked about the musical for two hours. Oprah, Sanders said, identified what he considered to still be a weakness: that the songs for Celie are not as strong as those for the supporting cast. At the end of the evening, she mentioned that she might come back the next weekend. "I told her: 'Please come as often as you like,'" says Sanders.

Sanders says he expects *The Color Purple* to open on Dec. 1 with advance ticket sales of about $5 million, a relatively modest amount. After that first performance, he is hosting a party at the New York Public Library. Oprah will be there. Alice Walker will be there. Quincy Jones will be there. Furman and Sanders have arranged for the Empire State Building to be lit in purple. The reviews will come out the next day. It will take a while before Sanders knows whether he has a smash on his hands or a flop. He has always said that the show would have to be discovered, Oprah or not. When it comes down to it, Sanders is still counting on word of mouth. ■

The Bright Lights Beckon

Hear *The Color Purple*: Download this original title song from the show.

Flop or Not? Take our quiz and test your knowledge of how other adaptations did.

Anatomy of a Megahit: How Judy Craymer manages the cottage industry that is *Mamma Mia!*

"I'm always happy to take a risk if it looks like it will be entertaining": Alice Walker talks about being involved in turning her Pulitzer-prize winning novel into a Broadway musical.

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How Tax Reform Adds Up

Two proposals would play out in dramatically different ways for business

BY HOWARD GLECKMAN

BACK IN 1986, THE LAST time Washington rewrote the tax code, it was easy for business to figure out what was happening: Congress turned tax reform into voter bait by cutting individual taxes by $120 billion. Then it paid for the largesse with a $120 billion tax hike on companies.

Now Washington is at it again, with aides to President George W. Bush hinting that rewriting the tax code may be his key goal for 2006. But this time, business' outlook isn't so clear. The President's Advisory Panel on Federal Tax Reform has proposed two ways to clean up the code, and the impact on companies could vary widely. As a result, Big Business could be deeply splintered if the President pushes sweeping reform.

To help sort the winners from the losers, *BusinessWeek* asked accountants Ernst & Young LLP to crunch the numbers. Their analysis—the first of its kind—shows how the changes would play out for hypothetical companies.

Ernst & Young shows where the battle lines might be drawn

At first glance, business' interests would seem clear: Support the panel's consumed-income tax, which would cut the overall tax from 25.9% of corporate income to 7.2%. By contrast, its simplified income tax plan would raise taxes for three of the four businesses created by E&Y, though that could be more than offset by tax cuts for investors.

Either system would mark a sharp change. Under today's code, industry-specific tax breaks create wide differences between the tax return of, say, a carmaker and a software developer. The new plans propose to wipe out 40 of those targeted breaks. Under those plans, what a business makes would matter less than where it makes and sells its products and how it finances itself.

For some industries, reform could cut taxes but hurt business. Take homebuilders and real estate agents, who are up in arms about the panel's proposal to curb the mortgage interest deduction. If that change drives down home prices, the housing industry won't be satisfied even if its own tax bill shrinks.

Under both plans, corporate tax rates would fall from today's top 35%. The new income tax would peg the rate at 31.5%; the consumption tax, 30%. Both would also change the way income from foreign operations is taxed, largely exempting revenues from foreign sales.

The other big difference: how capital equipment is written off. Today, companies must deduct such costs over many years using up to eight different schedules. For most businesses, the new in-

The New Hit

Four different types of companies, four different IRS tabs

COMPANY TYPE	ANNUAL TAX BILL (MILLIONS) CURRENT LAW	SIMPLIFIED INCOME TAX (% CHANGE)	CONSUMED INCOME TAX (% CHANGE)	WHAT CHANGES
"GLOBESPAN CORP." Multinational, $40 billion revenues	$703	$789 (+12%)	$219 (-69%)	Under CIT, heavy spending on equipment is written off immediately
"HOMEGROWN INC." Domestic manufacturer, $10 billion revenues	$220	$245 (+11%)	$126 (-43%)	Loss of big deductions more than offsets the lower rates
"TECHLABS CO." High-tech company, $5 billion revenues	$166	$180 (+8%)	-$439 (-364%)	Under CIT, exports—40% of this company's sales—aren't taxed at all
"SERVICEGIANT CORP." Large service company, $1 billion revenues	$52	$50 (-3%)	$46 (-12%)	Lower rates make it a winner under either reform plan

Data: Ernst & Young LLP

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come tax would collapse those depreciation schemes into one. Overall, that would be a bit less generous than today, but it would create big winners among heavy industry and losers among firms that mainly use short-lived equipment like desktop computers. The consumption tax would go much further, allowing companies to deduct the entire cost of equipment in the year they buy it. In exchange, companies could no longer deduct trillions in interest expenses.

How do these shifts sort out? For the four companies invented by E&Y, here's how taxes would change—and why:

TechLabs Co. This $5 billion outfit could develop software or make specialized computer equipment. Its production is in the U.S., but 40% of sales are overseas. Under the simplified income tax, lost deductions for state and local taxes and domestic manufacturing would more than offset the rate cut, raising TechLab's taxes by 8%. But under the consumption tax, TechLabs hits the jackpot. Its income from foreign sales escapes tax entirely, producing a mind-boggling 364% tax cut.

A real-life TechLabs might not enjoy such a windfall. Today, many companies shift their income from patents and licenses to low-tax countries while claiming expenses in the U.S. For businesses that enjoy such big breaks today, a consumption tax may not be so rewarding.

GlobeSpan Corp. Under the simplified income tax, this $40 billion multinational loses big tax breaks and sees its deduction for depreciation shrink by $57 million. Even with a lower rate, it pays 12% more tax. GlobeSpan would do much better under the consumption tax, largely because first-year expensing of its $800 million in capital investments outweighs the loss of its interest deductions.

HomeGrown Inc. Domestic manufacturer HomeGrown earns 90% of its $10 billion

Reform would give investors a break, too

in sales in the U.S. and borrows heavily. With the simplified income tax, loss of the domestic production deductions helps boost its taxes by 11%. Under the consumption tax, however, the company can exempt foreign revenues while expensing $246 million in capital costs. That outweighs its loss of interest deductions and cuts its tax by 43%.

ServiceGiant Corp. This $1 billion company could be a publisher or a systems integrator. Because it doesn't have much debt or equipment, it won't be affected by most of the proposed changes. But the rate cuts would trim 3% off its tab under the new income tax or 12% under the consumed-income levy.

Either plan would create big new tax incentives for individual investors. While many companies might pay the IRS more under the simplified income tax, the overall tax on corporate income—including individual taxes on capital gains and dividends—would fall. For instance, HomeGrown's $25 million corporate tax hike is more than offset by a $40 million tax cut for its investors. For many companies, "nearly all the good news happens at the shareholder level," says Thomas S. Neubig, E&Y's national director of quantitative economics and statistics.

The E&Y analysis makes big assumptions about how these four companies do business. For instance, adjust the mix of imports and exports, or of debt and equity, and some tax cuts could turn into hikes. But for businesses trying to figure out what sort of reform they like, these numbers could be a good early test. ■

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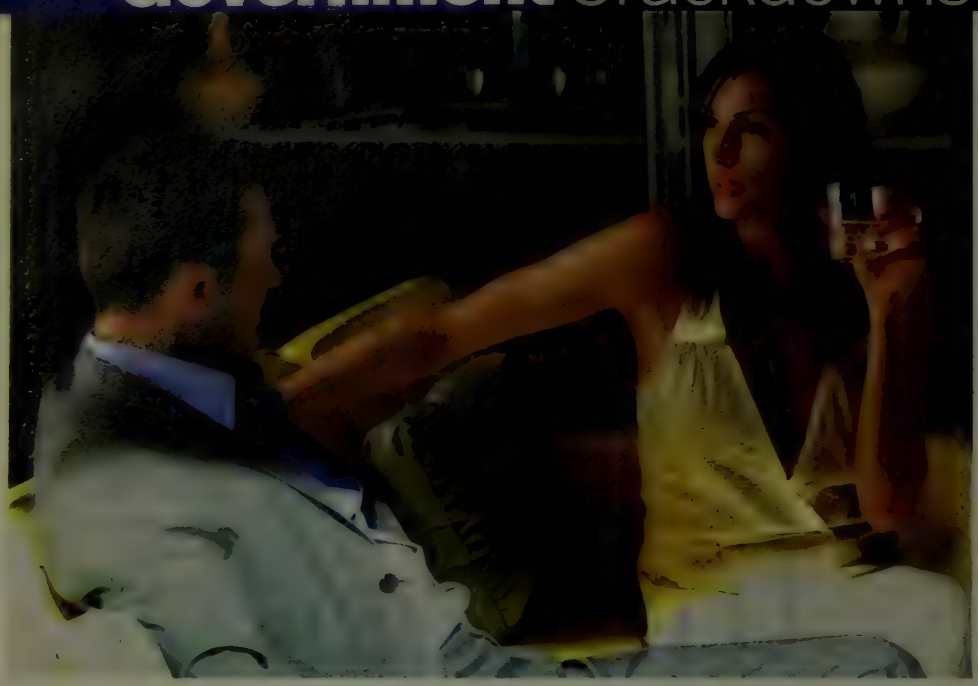

NIP/TUCK New restrictions are in the works

An All-Out Assault On Sexual Content

Washington is stepping up moves to get TV and movies to cover up and talk nice

BY LORRAINE WOELLERT

THE NATION'S SELF-proclaimed largest distributor of pornography became the latest target in the Bush Administration's escalating war on indecency on Nov. 4. Edward J. Wedelstedt, known in the trade as Mr. Big, copped a plea to serve 13 months in jail for fraud and distributing X-rated movies across state lines. "This guilty plea is a warning to others," said Assistant Attorney General Alice S. Fisher.

Pornographer perp walks are nothing new, but the smut smackdown is starting to spread beyond red-light districts. The Administration has launched a broad assault on sexual content that targets the entertainment industry from Hollywood producers to hotels. The offensive includes creation of a Justice Dept. Obscenity Prosecution Task Force and an anti-porn squad at the FBI, a crackdown on indecent programming by the new Federal Communications Commission chairman, and a wave of indecency legislation.

The push aims to pressure companies involved in films such as *Wedding Crashers*, TV shows such as *Hot Properties* and *Nip/Tuck*, and soft-core cable porn to tone down or face a backlash. But while Christian conservatives cheer, business is gearing up to take on the Smut Squad. On Oct. 28 a powerful coalition of 30 trade groups, including the U.S. Chamber of Commerce, the Motion Picture Assn., and the American Hotel & Lodging Assn., took up the banner to fight part of a Justice Dept. proposal flying through Congress. The legislation is aimed at child pornography traffickers, but it casts a wider net. Under current law, producers whose films depict actual sex acts must certify that performers are 18 or older. The bil would apply that rule t R-rated movies and othe shows that include simu lated sex. It would als force distributors, from TV networks to Ne service providers to hotels, to attest that n youths were involved.

TO PROTEST, CLICK HERE

BUSINESS' COMPLAINTS have elicite little sympathy from the Administration The growing popularity of broadband video cell phones, and peer-to-peer tech nology has pushed the indecency issue t the front burner, says Justice Dep spokesman Paul Bresson. And the por trade has been quick to capitalize on ne gadgets: Within days of the debut of Ap ple Computer Inc.'s video iPod, X-rate filmmakers had posted thousands of two minute skin flicks for download.

The FCC is already working to clea up old tech. Chairman Kevin Martin, longtime smut critic, recently hired on of broadcasting's most vehement foe Penny Young Nance, ex-president of th Kids First Coalition. Her allies in th family-values world helped drive th number of complaints about TV an radio indecency to 1.4 million—a coun inflated by form letters, critics say—i 2004. Her first move inside the FCC wa to set up a Web site with eas instructions on how to protest raunch shows. Now Martin is set to clear up backlog of indecency complaints, givin broadcasters a first look at what wi pass muster.

Many in Congress want to give regu lators more power. Senate Commerc Committee Chairman Ted Stevens (R Alaska) is crafting a bill to raise fines an give the FCC three-strikes authority t revoke repeat offend ers' broadcast licenses.

Business is fightin back. Even the skin-flic trade is starting to com out of the shadows. O Nov. 5 its trade group, th Free Speech Coalition hired former Assistant At torney General Rober Raben as a lobbyist. Busi ness executives aren' about to climb into be with the porn industr But in the eyes of socia conservatives, they al ready have. ■

–With Catherine Yan and Eamon Jave in Washingto

THE STAT

1.4

Complaints, in millions, to the FCC about indecent broadcasts in 2004

Data: Federal Communications Commission

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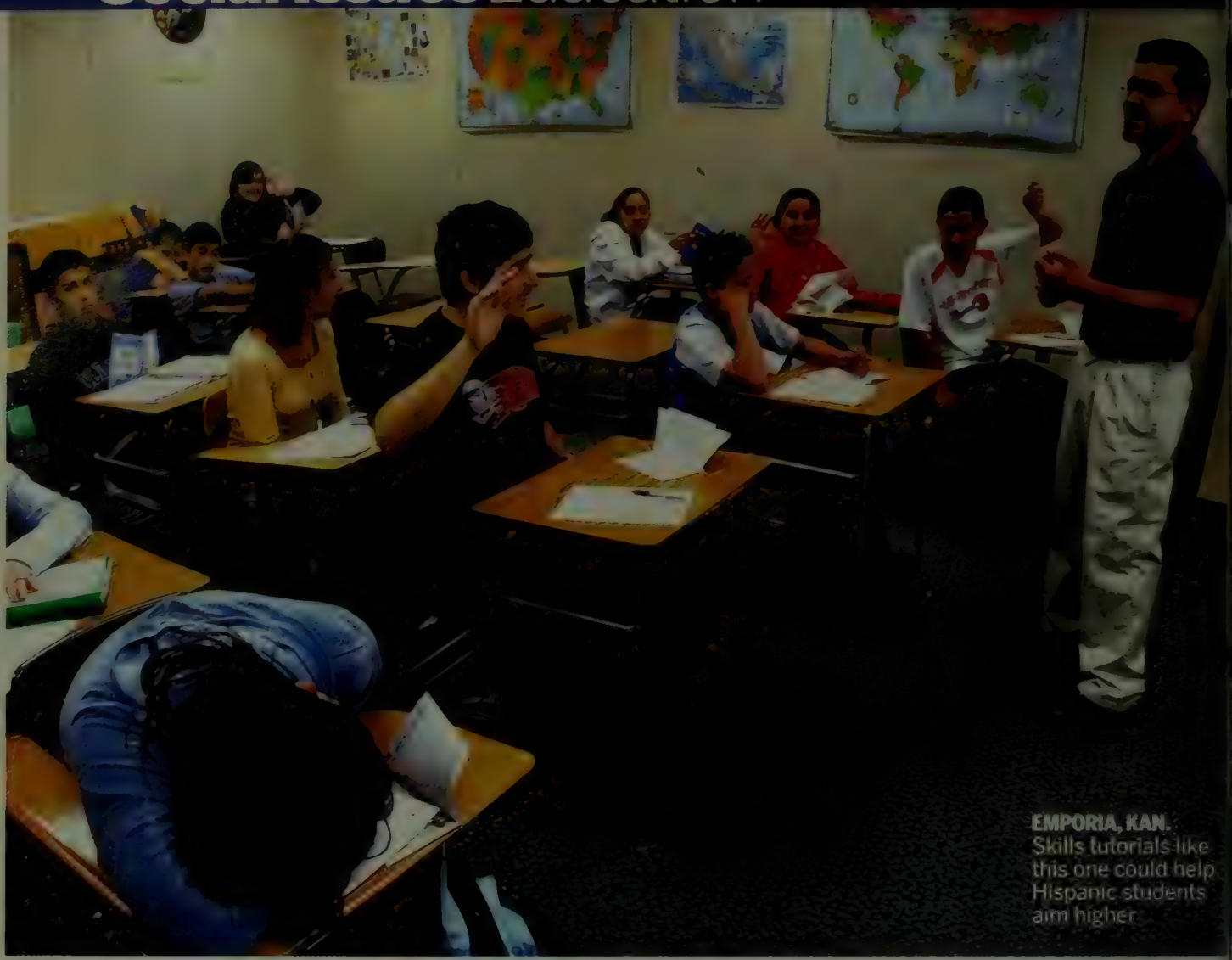

EMPORIA, KAN. Skills tutorials like this one could help Hispanic students aim higher

America The Uneducated

A new study warns of a slide for the U.S. as the share of lower achievers grows

BY WILLIAM C. SYMONDS

HOW DID THE U.S. BECOME the world's largest economy? A key part of the answer is education. Some 85% of adult Americans have at least a high school degree today, up from just 25% in 1940. Similarly, 28% have a college degree, a fivefold gain over this period. Today's U.S. workforce is the most educated in the world.

But now, for the first time ever, America's educational gains are poised to stall because of growing demographic trends. If these trends continue, the share of the U.S. workforce with high school and college degrees may not only fail to keep rising over the next 15 years but could actually decline slightly, warns a report released on Nov. 9 by the National Center for Public Policy & Higher Education, a nonprofit group based in San Jose, Cal The key reason: As highly educated bal boomers retire, they'll be replaced mounting numbers of young Hispani and African Americans, who are far le likely to earn degrees.

Because workers with fewer years education earn so much less, U.S. livi standards could take a dive unless som thing is done, the report argues. It calc lates that lower educational levels cou slice inflation-adjusted per capita i comes in the U.S. by 2% by 2020. Th surged over 40% from 1980 to 2000.

Not everyone is so pessimistic. Educ tion Secretary Margaret Spelling argu that President Bush's 2001 education r form law, the No Child Left Behind Act, working to lift minority education leve "It makes me bristle when I hear peop say, 'There's no way in hell we can ha our children reach grade-level proficie cy,'" she says.

Still, the Center's projections are esp cially alarming in light of the startling e ucational gains so many other countri are achieving. U.S. high school projectio even more alarming is the fact that

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Alger MidCap Growth Fund (A) 12.31.96 (MID-CAP GROWTH FUNDS)	1st (83/541)	1st (66/441)	1st (65/320)	2nd (168/577)
Alger SmallCap Growth Fund (A) 01.01.97 (SMALL-CAP GROWTH FUNDS)	1st (4/522)	1st (58/436)	3rd (223/327)	4th (454/546)

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During certain of the referenced time periods, the Funds experienced periods of negative performance results.

Source: Lipper, a Reuters Company, for the period ended 9/30/05. Lipper is a nationally recognized organization that ranks the performance of mutual funds within a universe of funds that have similar investment objectives. Rankings are historical and are based on total return with capital gains and dividends reinvested. Rankings do not consider sales charges. Lipper ranking is for the A share class only; other classes may have different performance characteristics.

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Investing in Dynamic Change

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many other countries are achieving startling educational gains. U.S. high school math and reading scores already rank below those of most of the advanced economies in Europe and Asia. Now education is exploding in countries such as China and India. There are nearly as many college students in China as in the U.S. Within a decade, the Conference Board projects, students in such countries will be just as likely as those in the U.S. and Europe to get a high school education. Given their much larger populations, that should enable them to churn out far more college graduates as well. More U.S. white-collar jobs will then be likely to move offshore, warns National Center President Patrick M. Callan. "For the U.S. economy, the implication of these trends is really stark," he says.

Callan's projections are based on the growing diversity of the U.S. population. As recently as 1980, the U.S. workforce was 82% white. By 2020, it will be just 63% white. Over this 40-year span, the share of minorities will double, to 37%, as that of Hispanic workers nearly triples, to 17%. The problem is, both Hispanics and African Americans are far less likely to earn degrees than their white counterparts. If those gaps persist, the number of Americans age 26 to 64 who don't even have a high school degree could soar by 7 million, to 31 million, by 2020. Meanwhile, although the actual number of adults with at least a college degree would grow, their share of the workforce could fall by a percentage point, to 25.5% (charts).

If current trends aren't reversed, U.S. living standards could dive

STEEP SLIDE IN TEXAS

THESE TRENDS AREN'T carved in stone, of course. Bush's No Child law is helping to lift minority kids' test scores, says Jack Jennings, president of the Center on Education Policy, a Washington think tank that studies No Child. But the gaps are still enormous. On the recently released National Assessment of Educational Progress exams, 39% of white eighth graders were proficient in reading, vs. just 15% of Hispanics and only 12% of blacks. "Given these scores, there's no way the country will reach the 100% proficiency goal" of the No Child law, predicts Jennings.

Even with No Child, backsliding already has happened in Texas, the laboratory President George W. Bush used for the law when he was governor of the state. Why? The Lone Star State's Hispanic population is exploding. Because minority students are far more likely to drop out of high school, Texas now ranks dead last among the 50 states in the percentage of adults who have a high school degree. That's down from 39th in 1990.

Similarly, Texas ranks 35th among the states in the percentage of adults who have a college degree, down from 23rd in 1990. State demographer Steve H. Murdock is telling anyone who will listen that Texas public schools will be 80% minority by 2040, up from 57% in 2000. If the education gap persists, he warns, the income of the average Texas household will fall by $6,500 by 2040, after inflation adjustments—potentially fueling a spike in poverty, the prison population, and other social problems. "We've been very hard hit," says Murdock.

In Texas and across the country, No Child's focus on test results skirts the biggest Achilles' heel of the public schools: the growing dropout rate. Nationally, the on-time high school graduation rate is lower now than it was in 1983, when the report *A Nation at Risk* first sounded the alarm about the nation's failing schools, says Michael Cohen, president of Achieve Inc., a nonprofit school standards group created by governors and business leaders.

In 2002 just 68% of high school students graduated four years after they started ninth grade. That's down from 75% in the early 1980s. True, many later earn a general educational development degree. But the GED has never been the same as a high school diploma. Once students quit school, it's difficult for them to make it into college, says Thomas G. Mortenson, head of *Postsecondary Education Opportunity*, a higher education newsletter.

Minority students who do get through high school face even greater obstacles in earning a bachelor's degree. Because many come from low-income families, they have been hit especially hard by the shift in student financial aid policy away from need-based grants toward loans and merit scholarships that favor the middle class. So just 10% of students from the bottom quartile of family income brackets earn a BA by the time they're 24, figures Mortenson, vs. 81% of those from the top quartile. "We are not dealing with the changing demography of the country," he says.

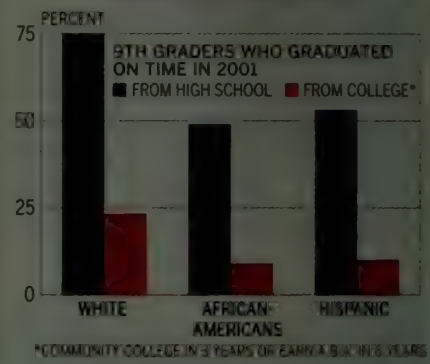
How can the trends be reversed? Jennings argues that the U.S. must push harder to get better teachers into poorer schools. States must also work far harder to keep students from dropping out of high school even as they raise graduation requirements. Today, only about a third of high school grads are prepared for college, estimates Achieve's Cohen. Many need remedial courses, a key reason why fewer than half of those who begin college earn a BA, says Cohen, whose group is working with 22 states to raise their high school graduation requirements. And more generous financial aid could make it easier for low-income students to go to college.

The prospects for U.S. education level are a lot like global warming. Since erosion occurs gradually, it's easy to ignore. But if the U.S. doesn't pay more attention, everything from its competitiveness to its standard of living could sink. ■

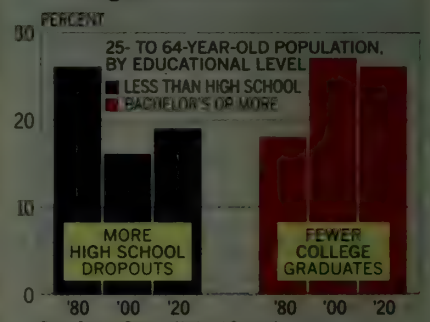
LOSING GROUND

As the country becomes more diverse...

...the educational gap between whites and minorities...



...could stall U.S. education gains for the first time



Data: Census Bureau, National Center for Public Policy & Higher Education

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The Patriot Act: Business Balks

It's joining critics who seek to curb the law's wide-ranging investigative powers

BY RICHARD S. DUNHAM

LAS VEGAS MAYOR OSCAR B. Goodman loves to remind visitors of Sin City's oh-so-discreet tagline: "What happens in Vegas stays in Vegas." But since the New Year's celebrations ringing in 2004, he has had to modify the motto. Fearing a terrorist attack, the FBI descended on casinos, car rental agencies, storage warehouses, and other Las Vegas businesses with sheaves of "national security letters" demanding financial records covering about 1 million revelers. Startled business owners who questioned the action were told they had one choice: cough up their documents or wind up in court. Now, a somber Mayor Goodman acknowledges, what happens in Vegas may end up staying in an FBI computer. "It's Kafkaesque," he says. "The central component to our economy is privacy protection. People are here to have a good time and don't want to worry about the government knowing their business."

The FBI carried out its document hunt under the Patriot Act, the anti-terrorism law passed hurriedly in the aftermath of September 11. The act allows investigators to demand that businesses turn over sensitive financial records, without specifying the investigation's target or why the files are needed. The outfit receiving a letter is permanently gagged, prohibited by law from ever disclosing that the feds came calling. Indeed, the statute is silent on whether company officials who receive an order can call a lawyer or appeal to a judge—although the Justice Dept. says it always allows businesses to seek legal recourse, behind closed doors and without the person appealing present. "Businesses want to cooperate in the war on terrorism, but this type of unchecked government power goes a little over the line," says Bob Shepler, director of corporate finance at the National Association of Manufacturers (NAM).

STRANGE COALITION

WITH MOST PROVISIONS of the Patriot Act due to expire at yearend, the Administration has been urging Congress to make its temporary police powers permanent. But an odd coalition is trying to scale back the government's reach—and it may be making headway. On Nov. 9, word came from Capitol Hill that the rising chorus of civil liberties complaints could produce a deal to temper some of the law's more intrusive features.

If that happens, corporate interests can notch up part of the victory to savvy lobbying. Concerned about the circumvention of due process guarantees—and about hefty compliance costs—a half-dozen prominent business groups have joined with the American Civil Liberties Union to push Congress to narrow the law's scope. What's surprising in today's with-me-or-against-me Washington is that the coalition includes such Bush allies as the NAM, the U.S. Chamber of Commerce, and the National Association of Realtors. "These are not groups that normally take on this Administration," says Susan Hackett, general counsel of the Association of Corporate Counsel, a coalition member that represents companies' in-house lawyers. "People in the business community clearly are worried."

Administration officials insist they haven't overreached. "The Patriot Act allows us to get a very limited set of records," contends one Justice official. "We are not inclined to ask courts to endorse fishing expeditions, and courts are loath to do so." Department officials say that judges have granted them access to business records under Section 215 of the Patriot Act just 35 times in the first 3½ years of the law, adding that those orders involved only data on driver's licenses, public accommodations, apartment leases, credit cards, and telephone use.

Security Risk
Business concerns about the Patriot Act searches include:

FISHING EXPEDITIONS
Open-ended demands for documents could expose corporate practices that prompt further government probes

PAPERWORK
Complying with document requests from investigators can be costly

But Justice also enjoys broader clout ınder the Act's Section 505—an expan- ion of national security letters, issued vithout a court order. Since 2001 the feds ıave served as many as 30,000 letters a 'ear, according to Administration sources ınd civil libertarians. Despite the volume ›f requests, one Justice official says: 'There has not been a single verified ıbuse of any Patriot Act authority."

Still, corporate lobbyists and business groups are increasingly concerned about he law's cost and potential for abuse. The ɔusiness alliance spelled out its reform ıgenda in an Oct. 4 letter to Senate Judi- ciary Committee Chairman Arlen Specter (R-Pa.). The groups argue that the Patriot Act's Sections 215 and 505 "allow the fed- eral government to require voluminous ınd often sensitive records...without [public] judicial oversight or other meaningful checks on the government's power." They say that compliance with the demands puts confidential financial data, trade secrets, and other proprietary information at risk. Another concern: the fear that multinationals could land in legal trouble abroad—particularly in Europe—for violating stringent privacy laws there if they comply with U.S. government demands for financial records.

The businesses with the most at risk are real estate agents, car dealers, casinos, jewelers, boat dealers, travel agencies, insurance brokers, Internet service providers, and pawnbrokers—all deemed to be financial institutions under a broad definition approved by Congress in 2003. "Our customers must be comfortable that sensitive financial information will remain confidential," says Tom Heinemann, a policy analyst at the Realtors' association. "Our industry wants to make sure that there are appropriate checks and balances in place to protect access to those kinds of records."

The Bush team wants to make the act permanent largely as is

DEAF EARS

WHAT'S MORE, THE business groups contend that the Patriot Act, as written, gives the feds carte blanche to rifle through corporate records. One worry: Like police searching a car trunk after a traffic stop, the feds could discover evidence of unrelated crimes or securities law breaches when they rummage through business records. "The sweep of government power is extremely broad," says Lisa Graves, senior counsel at the ACLU. "When you've got a hammer, everything starts to look like a nail."

Business groups say they already are getting pounded. They argue in their Oct. 4 letter that the law "does not impose any limit on the breadth of records" demanded by federal agents, and they are seeking "a meaningful right to challenge the order when the order is unreasonable, oppressive, or seeks privileged [business] information." The coalition has urged Congress to give companies the right to seek court permission to lift the act's lifetime gag orders, an idea that may be taking hold.

Few of these complaints are registering with the usually business-friendly Bush Administration. The Justice Dept. says that business has all the protections it needs. "There are sufficient safeguards that many choose to ignore," Attorney General Alberto R. Gonzales told the Senate Judiciary Committee at an April hearing. Among those: a right to appeal to a secret court and a limited right to counsel to comply with or challenge an order. Gonzales now favors including those guarantees in the rewritten Patriot Act, which will be finalized by House and Senate negotiators scheduled to meet for the first time on Nov. 10.

But Gonzales is likely to be disappointed by many of the other provisions negotiators are now hammering out. Both the Senate and House versions of the measure would allow a judge to modify an FBI

RECY
orders surrounding nal security letters ent businesses from cly disputing the nment's action or ing their names

PRIVACY
Multinational companies could face liability under strict European privacy laws for turning over customer, employee, or supplier records to the FBI

CHAIN OF COMMAND
Secrecy provisions in many cases prohibit financial officers from notifying corporate higher-ups about the government's order

order that was deemed unreasonably burdensome on a business. And on Nov. 9, the House directed its team to accept Senate-passed provisions setting a four-year sunset clause on many of the Patriot Act's key provisions, despite Administration opposition.

In final negotiations, the Senate is pushing its House counterparts to incorporate most of the safeguards sought by commercial interests. One big victory for the corporate coalition came on Nov. 9 when House negotiators agreed to permit businesses or individuals to seek judicial review of national security letters. Senate leaders believe they have an agreement on another top business concern: limiting the power of law enforcement to keep company records on file forever. A tentative deal would require investigators to return or destroy lists they've obtained, such as those covering airline passengers or casino customers, if the terror tip turns out to be a dud.

Bush's ratings may help business get what it wants

Less certain is the fate of a Senate-passed requirement that the FBI link the specific records that it's seeking to a specific suspect. The Administration is fighting to maintain its current power. The changes sought by business "are overly complex and will lead to litigation difficulties [in pursuing terrorist suspects] because it will require the courts to engage in a more complicated legal review," one senior Administration official argues. As *BusinessWeek* went to press on Nov. 9, congressional leadership sources said that no final deal had been cut on the sensitive issue.

In one area, business appears to be losing: Neither version addresses corporate concerns about exposing trade secrets or breaching customer privacy.

Corporate reps in Washington acknowledge that they had qualms about the Patriot Act from the start but say they didn't want to speak out against the key legislative underpinning of the war on terrorism immediately after September 11. But with George W. Bush's approval rating now hovering below 40%, Hill Republicans may have decided that it's wiser to stand up for their corporate donors than to stick with their embattled President. ■

Learning to Love Sarbanes-Oxley

A few companies have discovered that compliance actually helps to cut costs

BY AMY BORRUS

ASK ANY CEO: SECTION 404 of the Sarbanes-Oxley Act is the corporate equivalent of root canal. Big public companies spent thousands of hours and an average of $4.4 million apiece last year to make sure that someone was looking over the shoulder of key accounting personnel at every step of every business process, according to Financial Executives International (FEI). Designed to nip accounting problems in the bud before they blossom into fraud, Section 404 is a core provision of the 2002 corporate-reform law. The number of companies that disclosed serious chinks in their internal accounting controls jumped to 586 in the first four months of 2005 compared with 313 for all of 2004, according to Glass, Lewis & Co., a financial research firm. But that's a tiny fraction of all public companies, leaving most CEOs griping about an exercise that seems to be all pain, no gain.

Most CEOs—but not all. A few companies are discovering, to their surprise, that taking stock of internal controls can help beyond just unmasking accounting problems. By forcing executives to dig deep into how their companies get work done, Section 404 is

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enabling businesses to cut costs and boost productivity. "There truly is a silver lining" in 404, says Gary Moran, managing director of Alvarez & Marsal Business Consulting LLC. His firm and CFO Research Services sponsored a report that discusses the unexpected benefits that 404 yielded at Cisco Systems, Genentech, and other companies.

"DIRTY LITTLE SECRET"

OF COURSE, EVEN the most onerous rules handed down from Washington hold some advantage for somebody. In the case of 404, the vast majority of companies still thinks it's overkill. In the FEI survey, 94% of top executives at the 217 public companies it polled said the costs of compliance far outstrip any gains.

But for some companies, 404 documentation is turning out to be a catalyst for computer-system upgrades and other efficiency moves that chief financial officers have long had on the back burner. "The dirty little secret is that many CFOs love 404" because it has given a boost to initiatives that had trouble getting traction, says William J. McDonough, chairman of the Public Company Accounting Oversight Board, the agency that turned Sarbanes-Oxley's language on Section 404 into specific directions for management and auditors.

Consider Pitney Bowes Inc. For years, the Stamford (Conn.) mailing-and-document technology company had been fitfully trying to create central offices for accounts receivable, billing, payroll, and seven other functions that its business units were doing on their own. Being forced to review its internal controls—which cost Pitney Bowes $12 million last year—turbocharged that move. The company found, for example, that its accounts-payable units may not have had enough staffers to ensure that one person isn't both entering a vendor's invoices on the books and also paying the vendor's bill, something that could open the door to fraud, says CFO Bruce P. Nolop. And documenting everything that, say, a payroll office does lets Pitney Bowes meld the various units without worrying that key knowhow will walk out the door when employees leave or are redeployed.

PITNEY BOWES' BONUS Nolop sees opportunity in testing controls

The early results are promising. Pitney Bowes expects to save more than $500,000 in 2005 by combining four accounts-receivable offices into one. Testing the strength of controls "is really an opportunity to drive change that we all know is necessary, but that's hard to accomplish otherwise," says Nolop.

Similarly, at Genentech Inc., simply being armed with detailed reports on financial controls "sped up by several months" installation of a new computer system that consolidates its financial data, says Elaine M. Yang, director of general audit. The new system lets managers at the South San Francisco biotech behemoth spend more time analyzing data—such as how many orders came from one customer in the last 48 hours—instead of just gathering it.

At other companies, the 404 exercise revealed soft spots in business management, says Mary Driscoll, president of CFO Research Services. Take Cisco Systems Inc., which spent $50 million and 240,000 hours on its first-year audit of internal controls. The mind-numbing effort revealed opportunities to streamline steps for ordering products and service, making it easier for customers to do business with Cisco. Section 404 "forced us to make sure that when a customer calls, sales and support are integrated," says Amy Kwan, senior director of finance.

Other companies are using the paperwork generated to describe their internal controls as job-training manuals. "Once you have the procedures documented, new staffers can sit down with them and get up to speed on their job by virtue of facts, not folklore," says Thomas M. White, senior vice-president and CFO at Hub Group Inc., a transportation-management company in Downers Grove, Ill.

Still, even finance executives who are leveraging their Section 404 work don't feel that they're getting a full bang for their buck. "There's no doubt that 404 goes too far," says Nolop of Pitney Bowes. "You end up documenting things for the sake of documenting them, even if your judgment says you've gone a bit overboard." Pitney Bowes's exhaustive review—a task that involved testing 134 processes and more than 2,000 controls in 53 locations—found no significant weaknesses.

Companies shouldn't have to dig as deeply into their pockets this year. After 2004's rollout, companies have laid much of the groundwork. The PCAOB, meanwhile, is exhorting management to focus on critical controls and not sweat the small stuff. Dennis M. Nally, chairman of accounting firm PricewaterhouseCoopers LLP, figures that public companies will spend 25% to 35% less to check internal controls in 2005. But outside auditor fees, which rose 55% for big companies last year, may not decline. Nolop expects that Pitney Bowes's total tab this year, including auditor's fees, will run to about $8 million, a third less than in 2004.

That's still steep, but it may be a small price to pay for safeguards against fraud. And if companies can use the information to make other aspects of their business more efficient, so much the better. ■

A Provision's Silver Lining

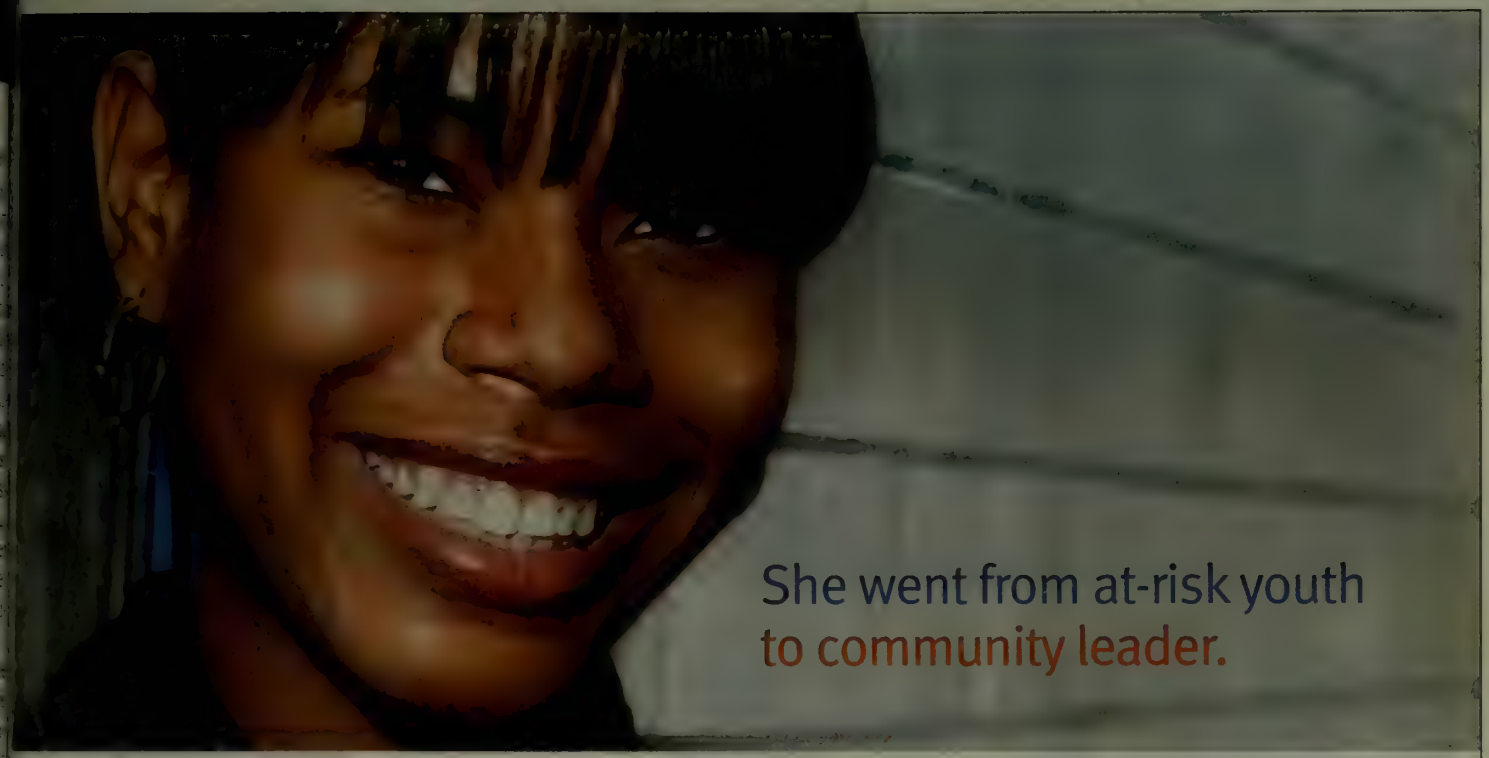
Meeting the onerous requirements of Section 404 of Sarbanes-Oxley is paying unexpected dividends for some companies

PITNEY BOWES quickly consolidated four accounts-receivable offices into one, saving more than $500,000 this year alone

CISCO combined separate steps for selling computer hardware and providing support so that customers could get one-stop shopping

GENENTECH got a new system to consolidate financial data up and running months ahead of schedule

Data: Companies



Ashley Bibbs

She woke to the sound of gunfire and watched helplessly as her father died in front of their house. Instead of staying angry, Ashley searched for ways to keep the same thing from happening to other kids.

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ON THE BLOCK A Beverly home in Little Rock

Just Who is Buying Beverly?

A $1.9 billion deal for the nursing home giant raises concerns about patient care

BY MARK MORRISON

FOR ARBITRAGEURS WHO make a living off the difference between a stock's trading price and what a suitor has promised to pay, Beverly Enterprises Inc., the giant nursing-home operator, seems like easy pickings. Beverly has agreed to be taken over by a group of real estate investors for $13 per share, yet the stock has been trading at under $12. If the $1.9 billion deal goes through in six months, an arb would get a big payday—a 15% annualized return.

But the arbs may also be sweating a few bullets. Beverly has been on a bumpy trip toward a critical Nov. 18 deadline to lock in its deal. That's when its chosen buyer, a company called North American Senior Care Inc., formed by real estate financiers expressly for the buyout, will have to disclose the sources of some of its funding and put up a $60 million deposit.

NASC already got a two-month extension to line up its financial commitments. Then Wachovia Corp. dropped out as the principal banker and Credit Suisse First Boston LLC stepped in. Some industry sources believe that NASC, which didn't respond to calls from *BusinessWeek*, may still be scrambling to recruit equity investors.

While NASC may yet come up with the money, all hell has broken loose in the politically charged nursing-home industry. Consumer groups, trial lawyers, labor unions, and politicians are mounting an aggressive attack against the takeover. They worry that patient care and accountability will suffer in Beverly's 350 nursing homes if NASC later sells the land as other nursing-home operators have done. "What we have here is the megachains being stripped of assets," says Barbara Hengstebeck, president of the National Citizens' Coalition for Nursing Home Reform.

Consumer groups, unions, and pols are all attacking the takeover

The Beverly-NASC deal is the target of lawsuits in Arkansas, Beverly's home state and one of its biggest markets, and legislative hearings in Mississippi. "There's a whole lot of taxpayers' dollars spent on this industry, and we're going to make sure it gets spent wisely," says Mississippi state Representative Jamie R. Franks Jr.

Now, the Service Employees International Union has jumped into the fray, alleging that other nursing homes taken over by outside investors have a pattern of increased patient-care violations. The SEI says the allegation is based on its own stud of state-by-state records. NASC isn't talkin

Beverly insists that concerns abou care are not warranted. "We don't believ the ownership structure will have an thing to do with running the business an the need for compliance or quality c care," argues James Griffith, senior vice president. "This industry is one of th most highly regulated in the country." H points out that even if the land is sol rent must be paid for the business mod to work—and that depends on the hom attracting and keeping patients.

UNKNOWN QUANTITY

GRIFFITH MAY BE RIGHT that an opera tor doesn't need to own the real estate ur der its nursing home to provide goo care. It's a model that some nursin homes have followed for years—and on that has been used in countless industrie to free up capital.

But Beverly isn't helped by question about NASC as a relativ newcomer to the field and it lack of transparency. Neithe its ownership structure no plans for Beverly have bee disclosed. Beverly says thos will come out in proxy mate rials. The main name linke with NASC is New York rea estate lawyer Leonard Grun stein, a partner in Troutma Sanders LLP. Grunstein' brother Harry was an archi tect of earlier buyouts c Mariner Health Care and Integrate Health Services Inc. that have purchase about 400 homes in 35 states. Neithe Grunstein returned phone messages.

If NASC is to prevail, it not only need to come up with the money but also t defuse the growing criticism it face Otherwise the deal will look increasingl risky, and those arbs are going to get a lo more nervous. ■

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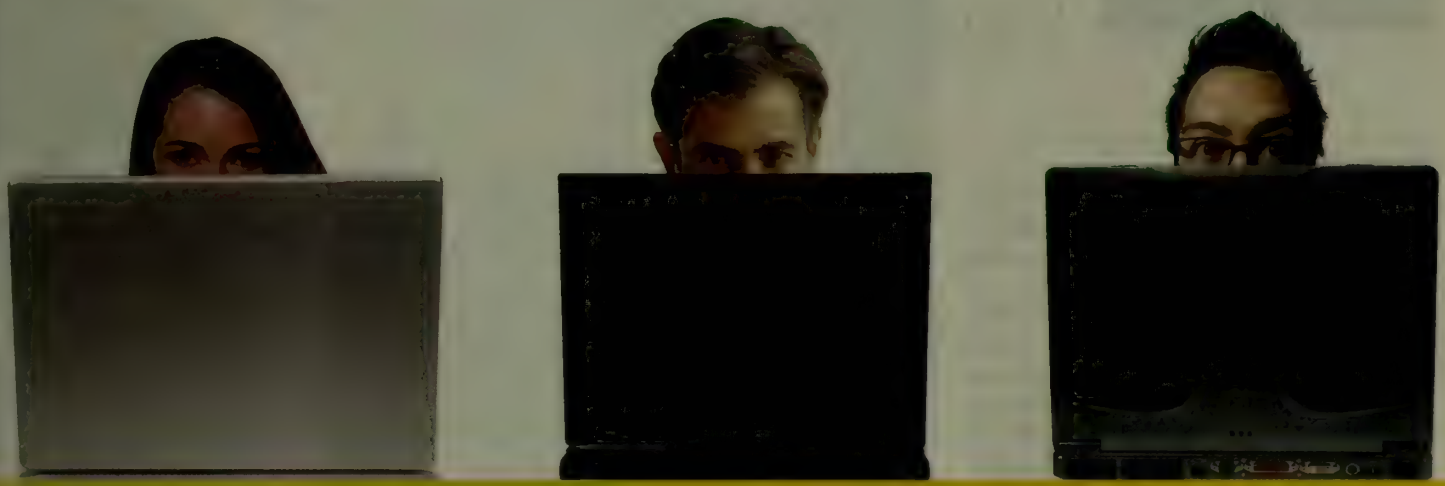

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The Improbable Flight of the Hornets

How George Shinn and his bedraggled team found happiness in Oklahoma City

BY MARK HYMAN

DAVID STERN CHOOSES his words with the care of a U.N. envoy on a peacekeeping mission as he recounts a recent conversation with George Shinn about temporarily moving the NBA's nomadic Hornets franchise from New Orleans to Oklahoma City. "I don't think he knew much about the city," the basketball commissioner allows. Hornets owner Shinn is considerably less diplomatic: "My exact reaction was: 'Oklahoma where?' I'd never considered this market."

Yet two months later, Shinn sits in the makeshift headquarters of the Hornets on the 18th floor of one of Oklahoma City's tallest office buildings waxing on about the Sooner State. And why not? Oklahoma has rolled out the world's longest red carpet for a basketball team beset by a history of mutinous fans, strife in the front office, and legal woes, including a lurid court case starring Shinn himself.

When Hurricane Katrina ravaged New Orleans in late August, Shinn's franchise was adrift, its arena in shambles, its fans scattered. The Hornets desperately needed a home away from home. Rejecting higher-profile options including Las Vegas, Nashville, and San Diego, Shinn settled on a city where the favorite local sport is drilling for oil. But with the NBA season barely beyond tip-off, Oklahoma City and the Hornets already have the makings of a match made in hoops heaven.

HOT TICKET

THE SCRAPPY STATE capital is still trying to shake off the pall cast by the Federal Building bombing 10 years ago, and lassoing the Hornets for even one season is a coup. City fathers have been angling for a big-league franchise for a decade and narrowly missed out on joining th National Hockey League during its la expansion in 1998. "There's a sense city has arrived when it gets a maj league franchise. Our CEOs here will te you that when they recruit from the Ea or West Coasts, the opportunity to live Oklahoma City has not stood out," sa Mick Cornett, the city's first-term may and a former TV anchorman in town.

Shinn may be an even bigger winne From the hero's welcome they've r ceived, you'd never guess his lowly Ho nets, who shifted from Charlotte, N.C., New Orleans in 2002, posted the NBA next-to-worst record last season, abysmal 18 wins, 64 losses—or that th trailed the 30-team league in atte dance, with an average of 14,221 sea filled per game.

In Oklahoma City, the Hornets, in probably, are a hot ticket. Only fi teams (Sacramento, Miami, Los Ang les, New York, and Chicago) have so more season passes. And on Nov. 1 a fu house of fist-pumping fans cramme into the Ford Center, the city's fou

SWEEP DREAMS In Charlotte 2001

BIO

George Shinn

The Hornets owner has gone from rags to riches to a series of setbacks

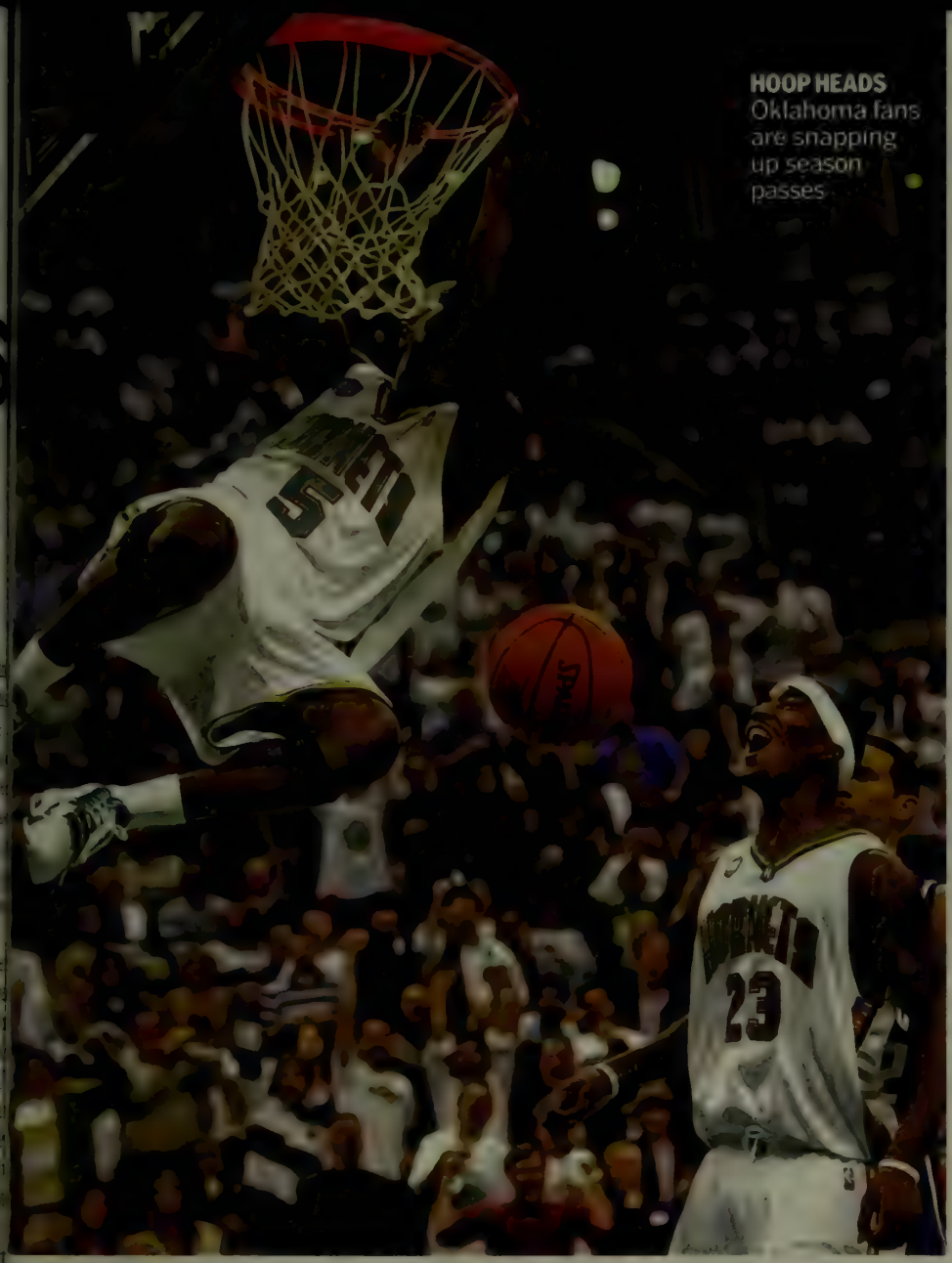
BORN on May 11, 1941, in Kannapolis, N.C.

GRADUATED from high school last in a class of 293. Attended Evans Business College in Concord, N.C., where he earned $100 for each new student he enrolled.

WORKED in a textile mill, a car wash, and as a school janitor. After graduating from Evans, he bought the school and other small colleges that offered 18-month to two-year programs, consolidating them under the name Rutledge Education Systems. In all, he owned about 30 schools that he sold in the 1980s for $30 million. In 1987 he paid $32.5 million for an NBA expansion franchise in Charlotte. The Hornets are now his main business venture.

WROTE a half-dozen marketing manuals and inspirational books, including *The Miracle of Motivation*, *The American Dream Still Works*, and *You Gotta Believe! The Story of the Charlotte Hornets*.

MARRIED to wife Denise, whom he met at a Hornets game. Three grown children from a previous marriage.



HOOP HEADS Oklahoma fans are snapping up season passes

year-old, 19,675-seat arena, to root the team on to a 26-point thrashing of the potent Sacramento Kings. Two victories in their first three games momentarily had the Hornets breathing the rarefied air of first place.

Even if attendance wanes, Shinn has a head start toward a winning financial season. In the deal that lured him, Oklahoma City offered an incentive-laden package, including a pledge to make up the difference if Hornets revenues from tickets, concessions, and sponsorships fall below $40 million this season. The money would come from city and state coffers as well as from a consortium of local business leaders. "We're a free-enterprise business. I didn't want to be in a position where I had to continue to borrow money to fund losses," says Shinn.

The Oklahoma City detour also allows Shinn to take a deep breath after a seemingly unbroken string of business setbacks, legal entanglements, and public-relations disasters. When Shinn, a self-made millionaire, joined the NBA as owner of the expansion Charlotte Hornets in 1988, he was a star as luminous as some of his players. As an inspirational speaker and author of motivational books including *Good Morning, Lord!*, Shinn could charge up a crowd.

His personal story was a charmer, too. Raised poor in North Carolina, with no hint that he'd escape his humble upbringing, he graduated dead last in his high school class. "I was the cutup, the guy who loved to clown," he says now. On a lark, he enrolled in a business school and discovered that he was a born salesman. Eventually he became the proprietor of a chain of business schools, selling them for $30 million shortly after buying the Hornets for $32.5 million.

The feel-good story doesn't feel as good these days. A failed and fractious bid for a new arena in Charlotte and, this year, a lawsuit brought by aggrieved employees who allege they were gypped out of overtime pay by the Hornets, have all chipped away at Shinn's reputation.

Most damaging, though, was an allegation of sexual impropriety. In 1999, Shinn was slapped with civil sexual assault charges after a 30-year-old woman claimed that he drove her from a drug rehab center, where she was receiving treatment, to his mansion. During the trial, he claimed the act for which he was charged was consensual. Shinn, who had been married for 28 years at the time, was found not liable after a trial that was a ratings bonanza for Court TV. Verdict aside, Shinn admitted on the stand to a two-year relationship with a Hornets cheerleader. He was divorced soon after the indiscretions became public. "I lost my wife. I didn't lose my life," says Shinn, now wed to a nurse he met at a Hornets game.

"WE'VE ANSWERED THE CALL"

SHINN RARELY SPEAKS about the debacle, but looking back, he says: "I have to face the fact that things are going to be on my tombstone. I can't change that." Shinn could not shake the stigma of the allegations in Charlotte. But most Oklahoma City officials are content to let the owner start with a blank slate. "I don't think we're judgmental," says Mayor Cornett.

Besides, what interests most Oklahomans is Shinn's basketball team. For now it's unclear whether the Hornets will play in the city after this season. The New Orleans Saints of the NFL may be headed for San Antonio. But Shinn professes loyalty to his team's home city and leaves the impression that he'll take the Hornets back to New Orleans as early as next season.

If that happens, Oklahoma leaders say their gambit still will have paid off. A year from now they will have demonstrated to the NBA or NHL that Oklahoma City is ready and able to support a major league franchise. "We know this is New Orleans' team. We hope and expect they can go back. At the same time, we've answered the call and proven ourselves," says Clay Bennett, president of private investment firm Dorchester Capital, who is himself one of the guarantors of the Hornets' deal.

Shinn agrees. Sitting on a bench outside his office building watching workers stroll by, the owner says: "Oklahoma City has been a well-kept secret, but it's out now." ■

PINCHED Produce and gas are up, and that raises worries about the future

Inflation: Shoppers vs. the Bond Market

Consumers are spooked by high prices. Traders aren't. Who is right?

BY PETER COY AND RICH MILLER

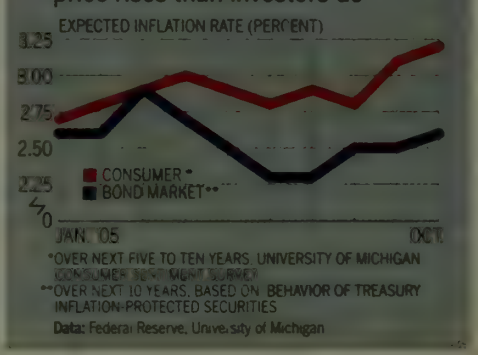
HAS THE BOND MARKET visited the produce aisle lately? Has the bond market filled up its gas tank this fall? Has the bond market paid the college tuition bills for its smart little offspring?

Apparently not. Because the multitrillion-dollar bond market—which is ordinarily terrified of inflation—is still fairly relaxed about the recent leap in consumer prices. As of Nov. 8, investors were expecting inflation to average only 2.6% annually over the next decade, the same as over the past one. That's based on the Federal Reserve's analysis of yields on ordinary Treasury bonds and inflation-protected securities. Bond traders seem convinced that the 4.7% jump in prices during the past year, led by energy and fresh fruits and vegetables, won't be repeated.

Ordinary Americans aren't as nonchalant. Expectations of inflation are at an eight-year high in the University of Michigan's Consumer Sentiment Survey, with consumers predicting a 3.2% inflation rate over the next 5 to 10 years, up from the 2.7% expected last January. "Gasoline has gone up," says Marguerite Melvin, a legal secretary in Manhattan. "Taxes keep going up. College tuition. Even the clothing stores where you used to find good value—they've raised their prices."

DIVERGING VIEWS

Ordinary Americans see faster price rises than investors do



This disagreement matters because beliefs about where prices will go tomorrow are a critical determinant of behavior today. For example, businesses that expect more inflation will negotiate higher prices with suppliers and customers—and will probably allow higher pay raises. And if the Fed sees inflation expectations rising, it's more likely to boost interest rates to avoid an inflationary spiral.

"NOT AS TAME"

RIGHT NOW, business executives are torn over whether consumers or the bond market are right about inflation. A survey by forecaster Economy.com Inc. shows nervousness—with 25% of businesses listing "labor costs and availability" as their most pressing problem, up from 11% in March. Rising material prices have socked many. "Inflation is not as tame as it was over the past 10 years," says Kenneth Phillips, CEO of Impaxx Inc., a Lakewood (Calif.) specialty packager. Some industries, such as hotels, have been able to raise prices because demand is strong. "Rarely have we seen a more favorable pricing climate," Marriott International CEO J.W. Marriott Jr. said last month. Others, though, don't believe they can raise prices even though their costs are up. On Nov. 8, the National Federation of Independent Business announced that the share of companies planning to raise prices in the next three months fell in October to its lowest level in 1½ years.

Why the disparity in expectations? Economist Ricardo Reis of Princeton University says that consumers absorb new information more slowly than the bond market does. So the bond market may be reflecting the latest drop in energy prices, while consumers are still focused on the September peak. "Businesses have the best fix" on inflation, argues Mark Zandi, chief economist of Economy.com. "It's not the screaming problem that consumers make it out to be. But neither is it the nonproblem investors see. It's a problem in the making."

If inflationary expectations become ingrained in consumers and businesses, the Fed will have to crank interest rates very high to squeeze them out, most likely causing a recession. If they can be lowered quickly and gently, the economy will continue to thrive. The bottom line: What matters most is not what inflation was, but what people think it's going to be. ■

"WE'RE ALL HAVING FUN" Ex-Sugen President Shawver runs Phenomix

The Spirit of a Startup Lives On

Sugen got taken over, but its novel cancer treatment is heading toward FDA approval

BY AMY BARRETT

IT SOUNDS LIKE A CLASSIC DEBACLE. A small biotech firm battling difficult odds and major setbacks discovers a promising drug for cancer. But after a series of mergers, the upstart is swallowed by a pharmaceutical goliath and operations are shut down. Although the big drugmaker continues to develop the treatment, the innovative team behind it is scattered to the winds.

That, in a nutshell, is the history of a once-hot biotech firm called Sugen. But it is hardly a sob story. The chronicle of the company and its drug, Sutent, clearly illustrates how marriages between pioneering biotech companies and pharmaceutical giants can turn out to be both disruptive and productive.

Considered one of the most innovative biotech startups of the mid-1990s, Sugen pioneered a first-in-class drug for two cancers that are extremely hard to treat: renal cell carcinoma and gastrointestinal stromal tumors (GIST). After going through three successive mergers, the Sugen team was disbanded in 2003 by Pfizer Inc., its final owner. The drug survived, however, and is widely expected to win approval from the Food & Drug Administration within months.

Former Sugen scientists are fueling innovation

The lesson? Small biotech operators may have the relentless focus—what Sugen veterans call a touch of insanity—that enables them to buck conventional wisdom and make important discoveries. But it's Big Pharma's dollars and expertise that often gets these therapies to market. And once the Pfizers of the world take over, those insane biotech veterans fly off to start the whole process over again. "One could argue that this is how things in the biotech industry are supposed to happen," concludes Dr. George D. Demetri of Dana-Farber Cancer Institute in Boston, a close observer of Sugen's life cycle.

SOUTH SAN FRANCISCO HUB

TODAY, FORMER SUGEN scientists are fueling innovation around the world. Many stayed in the South San Francisco area, a region so thick with biotech firms that there's a standing joke about people changing companies without changing parking spots. Genentech Inc. and Chiron Corp. each host a number of Sugen vets. Others are involved in a new generation of startups. Sugen co-

founder Axel Ullrich has even licensed back a Sugen patent from Pfizer and is using it as the basis for a new cancer therapy at another company he has started. "We are all having fun in our new jobs," says former Sugen President Laura Shawver, who now runs Phenomix Corp. in San Diego. "We think we'll get to develop other novel drugs."

Sugen's trajectory will probably be followed by many biotech startups in the years ahead. Big Pharma companies are suffering from near-empty product pipelines and looming patent expirations. At the same time, a weak market for initial public offerings has made biotech companies more receptive to selling out than they were even a few years ago. Merchant bank Burrill & Co. says that in the first nine months of this year the 20 largest pharmaceutical companies made 13 acquisitions, compared with just 15 for all of 2003 and 2004.

Sugen, like many other biotech companies, grew out of the work of two pioneering scientists, Ullrich, a director of the Max Planck Institute of Biochemistry in Munich, and Joseph Schlessinger, now a professor at Yale School of Medicine and co-founder of a new startup, Plexxikon Inc. The two focused on proteins called kinases that regulate the way messages pass between the outer surface of a cell and its inside. When kinases go awry, they can send out signals that lead to uncontrolled tumor growth.

ORANGE ALERT

THE SUGEN TEAM spent several years coming up with compounds that would block certain cancer-promoting kinases. One family of related chemical compounds seemed to hit the chosen target. Jerry McMahon, who joined Sugen in 1993 and was president when Pfizer shut it down in 2003, says a larger company might have played it safe and continued searching for other classes of compounds. But with limited funds and a gut feeling that this group of molecules could pay off, Sugen scientists zeroed in on them. (Sugen's commitment to the compounds literally left a mark: The chemicals had a distinct orange hue, staining Sugen's labs and equipment a strange orange color.)

Like many startups, Sugen's culture was one of working hard and playing harder. Executives and scientists often put in nights and weekends. But each week the staff wrapped up with a TGIF party. The Halloween parties were legendary, says K. Peter Hirth, president of Sugen during the 1990s. Hirth once made a presentation to the board on Halloween decked out in a Snow White outfit complete with fake eyelashes.

Despite all the levity, Sugen was under considerable pressure. It had gone public in October, 1994, and McMahon says Sugen rushed its lead compound, known as SU5416, into development too quickly in an effort to show stockholders it could produce results. The scientists could have used more time to improve the way SU5416 was absorbed in the body. Granted, successful early results with SU5416 helped attract Pharmacia & Upjohn, which bought Sugen for $650 million in 1999. But the drug failed in human trials a few years later. Sugen veterans say that if the company had been independent, it would have been tough after such a failure to raise enough money to keep going.

NEW LIFE Strawn is now at Pfizer

A Long Road

How a promising cancer treatment survived a wave of drug-industry consolidation

1991 A startup called Sugen is formed to commercialize the work of scientists Joseph Schlessinger and Axel Ullrich.

1999 Researchers synthesize a molecule called SU11248—later named Sutent—and the startup is bought by Pharmacia & Upjohn.

2000 Pharmacia & Upjohn merges with Monsanto Co., and the new company is named Pharmacia.

2003 Pfizer buys Pharmacia, shuts down Sugen's offices in South San Francisco, and initiates late-stage testing of Sutent.

2005 In one trial, Sutent improves the survival of cancer patients who have grown resistant to the drug Gleevec, and the Food & Drug Administration begins reviewing an application to approve the drug.

CLEAN HIT

THANKS TO PHARMACIA'S resources, Sugen was able to switch focus to a second compound already in early clinical trials. Then it was called SU11248; today it's Sutent. But the drug was controversial. While SU5416 blocked only one kinase, Sutent targeted several. That sounds good, but it made the drug a hard sell, given that it was following on the heels of Gleevec, a revolutionary single-target cancer drug from Novartis that won approval in 2001. Gleevec's success sparked an industry-wide enthusiasm for cancer drugs that take aim at one cellular target—a nice, clean hit.

Pharmacia, meanwhile, had merged with Monsanto Co. in 2000 and dropped Upjohn from its name. Executives at the newly created megapharma were concerned that Sutent's multitarget activity would produce too many side effects. At this juncture, Sugen's relative autonomy within Pharmacia was a boon. If not for that, argues ex-Sugen President Shawver, there would have been little leverage to push Sutent into clinical trials in 2001, and the drug might have died. "With major breakthroughs there is usually someone very passionate driving it," says Fred Hassan, Schering-Plough Corp. CEO and former head of Pharmacia. "Big companies are not good at that passion."

The passion was extinguished in 2003 when Pfizer bought Pharmacia. Pfizer already had a large lab in La Jolla, Calif., working on kinases. It decided to close Sugen's Northern California offices, and only a small fraction of Sugen's 350 employees stayed on. By then, however, the drug was far enough along that Pfizer was willing to throw its considerable weight behind it, backing 50 trials on Sutent worldwide. Pfizer says that Sutent appears to improve survival for patients with renal cell carcinoma, a nasty and hard-to-treat cancer—and that it extends survival for GIST patients who are resistant to Gleevec. It is also being tested against neuroendocrine and breast cancer.

All of this delights Laurie M. Strawn, one of the few ex-Sugenites who stayed with Pfizer. She and her former colleagues talk of a reunion if the drug gets O.K.'d. But don't expect Pfizer to host it. "We tend not to have parties," says Martin Mackay, Pfizer's head of research and technology. "We just get on with our work." Not such a bad thing. ■

–With Catherine Arnst in New York

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valuating Your Web Host: lo Time Like the Present

Competition in the Web hosting industry has ulted in the availability of feature-loaded hosting kages at all-time low prices and has many SMBs ndering if it's time to switch web hosts. Here are me tips for determining whether a change is the ht move and what to do if the answer is 'yes.'

Uptime is still the primary concern for hosted sites. your site is frequently "down" because your Web st is having technical problems, think about going st shopping. Just remember that it would take a nsiderable investment with any Web host to sure 100 percent uptime, so the occasional hiccup ctually OK, as long as the host's customer support can get you quickly back up and running.

Your hosting package must accommodate your business' needs. It's not uncommon for profitable and successful companies to audit their hosting plans and find that they've been operating with the absolute minimum technology and no data backup or redundancy. Thoroughly discuss your specific requirements with your Web host and purchase a package with the technology to match.

Today's uber-competitive Web hosting market is all about value. Hosting companies are offering more of it than ever, so it's worth doing some comparison shopping. Look at what you're getting with your current plan versus what you're paying and then see what's available elsewhere. Be particular and remember your company's unique needs.

If your evaluation concludes that it's time for a new host, remember that bigger is better. The larger hosting companies offer unmatched reliability, connectivity, and technical resources. SMBs often go with small local or regional providers that just don't have the guns the big players do, which can ultimately effect your site's quality and reliability. Do some research on a potential new Web host. There are a number of online forums with reviews of hosts, just be open-minded since they're often wrought with undue negativity. Read with a grain of salt and you're sure to glean some helpful advice. Hosting industry and IT magazine Web sites are also great sources of objective information.

To read the full report, go to www.technology-reports.com/1and1.asp

1&1

1&1 Internet Inc. is a subsidiary of United Internet, a profitable public company with 4,700 employees and a market cap of $1.7 billion. 1&1 was established in 1992 and has registered over 5.1 million domain names and operates more than 28,000 servers run in its four state-of-the-art data centers. 1&1's global community is over 4 million customer contracts strong. The company's U.S. headquarters is located in Chesterbrook, PA. For more information, please contact the company at **www.1and1.com** or **1-877-461-2631**.

RSS: What Marketers Need to Know

Today's online marketers want a communication channel that's 100-percent deliverable and secure, able to be personalized, targeted and measurable. International analyst firm JupiterResearch believes that RSS, the technology behind blogs, could be the answer.

RSS (or Really Simple Syndication) in its present form is a simple content publishing mechanism that broadcasts content to any user who subscribes to a feed. It is growing in popularity every day. While currently only four percent of Internet users say they use RSS, an October 2005 report by Yahoo! found another 27 percent consume RSS content without knowing it.

Using RSS for a corporate blog? It's a better tool for direct marketing.

New solutions are transforming RSS from a one-to-many communications medium into a targeted, one-to-one marketing channel. What JupiterResearch calls individualized RSS (IRSS) allows subscribers to easily express preferences for distinct content categories and receive customized feeds. Because the feeds are individually unique and measurable, they enable marketers to communicate with subscribers based on demographics, past behavior, or any other segmenting attribute using direct marketing techniques.

Additionally, messages sent through individualized RSS feeds keep the same level of 100-percent deliverability as traditional RSS feeds, as well as the same high security. The origin of an RSS message can't be spoofed, and online communications can't be used for phishing.

JupiterResearch believes that marketers who begin to use IRSS-feed marketing sooner will likely have a competitive advantage over late adopters.

To read the full report, go to www.technology-reports.com/silverpop.asp

silverPOP

Silverpop, with offices throughout the United States and in the United Kingdom, helps marketers cultivate and maintain long-term strategic relationships with customers. Silverpop's new RSSDirect™ product is the first commercial-grade solution for individualized RSS content creation and distribution, giving businesses an unprecedented new way to communicate with customers. To receive the JupiterResearch report about IRSS along with Silverpop's "RSS Marketer's Handbook," visit **www.silverpop.com**.

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New Rule: Web Services Security For The Automated Web

Web services: Some call it the second wind of the Internet, others a way to enable "Service Oriented Architectures or SOAs" while still others define them as "business on demand". What ever the catch phrase, Web services are making waves across industries and organizations.

It seems just yesterday that Web sites redefined commerce and community by creating new value, new opportunity and new growth from the outside and into the enterprise. Web services are creating similar transformational impact on the way companies do business - this time from the inside out. Web services are a way to glue together databases, Web sites and applications to create orchestrated and reconfigurable business activity. Customer orders can originate at an on-line shopping cart, flow to a distribution center, while triggering events such as shipping, payment and inventory replenishment.

On the flip side, Web services change the rules of security by introducing a variety of new threats that need specialized countermeasures:

- Cross-organizational information leakages
- Enterprise application integration disruption
- Unauthorized usage of application services
- XML-vectored viruses, spyware a unwanted software
- Compliance, privacy and workflow violati

If you are using or considering Web servi eXtensible Markup Language (XML) or Servi Oriented Architectures (SOAs) - make your se rity moves wisely. Short of encrypting ev piece of data and guaranteeing bullet-proof acc control mechanisms, information will inevital get into the wrong hands. A comprehens approach to Web services and SOA security m be able to address XML viruses, spyware, cred tialed users, insider threats as well as rogue ha and attacks.

Any enterprise working with Web servi must make their security moves wisely.

To read the full report, go to www.technology-reports.com/forum.asp

FORUM SYSTEMS™ THE LEADER IN WEB SERVICES SECURITY

Forum Systems, Inc. is the leader in Web services security with a comprehensive suite of Tru Management, Threat Protection and Information Assurance solutions for the Automated Web. Foru Systems flexible hardware, software and embedded products make vibrant business communicatio possible by actively protecting XML data and Web services across networks and business boundaries. Tel: 801-313-4400 Web Address: www.forumsys.com

Project & Portfolio Management with On Demand Web-Based Access

Companies today must get things done at a lower cost and with lower risk, making Portfolio and Project Management (PPM) solutions a "must-have" for improved project and process success and productivity. But traditional project portfolio management solutions are usually very complex and require complicated interfaces and customization.

This is why "on demand" delivery of PPM solutions — often referred to as software-as-a-service — is increasingly gaining traction with mid-market companies and divisions of Fortune 1000 enterprises. This technique of delivering software helps lower enterprise application costs while boosting the ability of an organization to successfully plan, execute, and report on projects.

The web-based PPM workspace is important for keeping project management decentralized and ensuring that knowledge is shared across the ent prise. In addition to knowledge-sharing, the we based platform is used to automate & man resource planning, project management, work-fl and collaboration. The bottom line benefits of demand PPM are:

- Web-based on-demand project portfolio ma agement allows companies to focus on manag their business instead of managing their project po folio management software.
- Web-based delivery removes the hass headaches, and excessive costs associated with tra tional enterprise software applications.
- Whether hosted by an application vendor or your own server, an on-demand platform means e adoption, simple deployment, and low maintenanc

To read the full report, go to www.technology-reports.com/eproject.asp

eProject™

eProject delivers the only on-demand project and portfolio management solution for the extended enterprise. eProject is an intuitiv unified platform that enables users to maximize project ROI by compressing project cycle times, identifying best practices an optimizing resource allocations, with rapid deployment and quick adoption. eProject is used by more than 350 companies worldwid including BASF, BP, Cushman and Wakefield, Dow Chemical, Honeywell and T-Mobile. Seattle, WA • 206-341-9117 • www.eproject.co

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lose the CRM Gap... Only Surveys how What Customers Really Think

.S. companies lose half of their customers every years, and worse, only 4% of dissatisfied clients ever let you know about it. On average, a busi- s will spend six times more to attract new cus- ers than it does to keep their current ones. Today, iness executives must act quickly to implement ctive customer loyalty programs and reduce cus- er defection. Customer relationship manage- nt (CRM) systems have been widely adopted to ster these efforts, but an important question has e unanswered. The "Why" question. Why has a tomer chosen to do business with you, or why a prospect choose NOT to do business with you?

What CRM does best is provide the quantitative data that characterizes a customer–who, what, when, where, and how much. What CRM cannot provide is the insight into why they chose you? What are they happy about? Where are you lacking? This often elusive qualitative data is every bit as critical as transactional history. Giving customers a voice in the relationship is essential. Without understanding your customers, it is impossible to satisfy them and keep them loyal.

Practically speaking, meeting with every client does not scale, so many organizations are turning to online surveys for real-time cost effective insight. Using web surveys, companies can monitor satisfaction levels, evaluate influencing factors and take corrective action to meet customer needs, boost satisfaction and enhance retention efforts.

Survey software allows business managers to transform CRM and B2E initiatives from buzzwords into practical, cost-effective programs. With minimal expertise, virtually anyone can use surveys to create feedback channels quickly and easily. Enterprise survey software goes a step further by providing a systematic and controlled platform that can be integrated with business processes and customer life cycles. Build a feedback culture today—your customers have the answers you need.

To read the full report, go to www.technology-reports.com/inquisite.asp

inquisite® web survey system

Inquisite provides enterprise survey software and services. Our technology helps business managers collect and analyze customer intelligence for improved B2C, B2B, and B2E results. For practical tips on how to get started, see our video tutorials, white papers, case studies, savings calculator, and more. Still not convinced? Try us for free! To create your feedback culture and gain critical customer insights, call 800.581.7354 or register for your FREE TRIAL at www.inquisite.com

nsuring Security and Reliability n Web Services Deployments

As enterprises today increasingly depend on IT to lp drive business innovation and provide compet- e differentiation many are turning to web services d Service Oriented Architectures (SOA) to create flexible and agile IT infrastructure necessary to be le to be responsive to changing business demands. e potential for Web services to deliver consider- le business benefits by connecting organizations to rtners and customers cannot be overlooked in day's intensely competitive marketplace. However, e flexibility provided with web services also intro- ces a significant degree of complexity that is con- tently underestimated.

Testing the security, compliance, and reliability of web services is paramount to successful SOA implementations, particularly those that are externally facing and business critical. Enterprises need to be able to certify and approve services for business and IT standards and deployment readiness. Services need to scale for availability, reliability, integrity, reusability and overall quality. These requirements create the need for a new SOA-specific testing paradigm and test tools that can test the complex layers of a web services transaction and guide the control and quality of an enterprise's SOA.

Services impose specialized testing challenges for SOA implementations. Testing tools must be able to inject realistic usage scenarios onto the infrastructure and validate interoperability as well as transaction completeness for transactions spanning multiple services and involving multiple messaging protocols. Testing must address verification of a service's functionality as well as its performance, scalability and security. With the highly interactive and interdependent nature of SOA based applications even small changes can cause major disruptions. Because reuse, service access and service availability are fundamental to achieving a robust service oriented architecture, automated regression testing should be an integral test process.

A new class of automated SOA-specific testing solutions has emerged to support the needed testing paradigm. These should be considered when migrating to SOA.

To read the full report, go to www.technology-reports.com/parasoft.asp

PARASOFT. We make software work.

Parasoft is a leading provider of innovative software solutions for automated software test and analysis and the establishment of software error prevention practices as an integrated part of the software development lifecycle. Parasoft's product suite enables software development and IT organizations to significantly reduce costs and delivery delays, ensure application reliability and security, and improve the quality of the software they develop and deploy through the practice of Automated Error Prevention. Monrovia, California. www.parasoft.com (888)305-0041 Ext. 3501 or info@parasoft.com

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Keep Phone Lines Operating – Even When Catastrophe Strikes

The current hurricane season has triggered a wake-up call throughout the business community. Business leaders seem to finally recognize that catastrophic events such as hurricanes, floods, and earthquakes can strike with little or no notice, potentially leaving them without a base of operations. With phone lines dead, employees can't communicate, leaving companies unable to deliver vital customer services.

With employees scattered during evacuations, displaced companies must scramble to patch together communication channels in the hopes of restoring some basic level of operations and customer service.

The need for assured telephone communications has given rise to a new breed of Web-based call response management services that effectively eliminate the need for centralized hardware or software that is vulnerable in an unexpected event.

Hosted phone services provide all the clarity, functionality and portability of systems used throughout the business community – from small proprietorships to multinational corporations. However, that's where the similarities seem to end.

Hosted phone services are not only much less expensive (as little as $15 a month), but offer a much wider range of services and flexibility in how or where calls are answered and routed. From toll-free numbers and find-me/follow-me call forwarding, to Autom Call Distribution (ACD) and instant conferenc most hosted services provide all the latest technolo

These services route incoming calls to any desig ed phone, wherever the employees happen to be their office, on their cell phone, at home, or makeshift office three states away. In fact, since emp ees don't have to be in one centralized location, m businesses are already looking closely at hosted response management services to establish or rep expensive help desks or centralized call centers.

Disasters not withstanding, leaders are increasir focusing on managing risks and ensuring continu customer service. The trend toward hosted response management services is becoming evide

To read the full report, go to www.technology-reports.com/halloo.asp

Halloo Communications, Inc. is a leading provider of hosted telephone communications services for businesses of all sizes. Our innovative, We based solutions provide instant ROI, with intelligent call routing and unified messaging abilities for general phone service, as well as for special nee such as help desks or call centers. Halloo service plans deliver high-profile call system features at a low monthly cost. For information on host phone service plans, contact Halloo at 400 Oyster Point Blvd., Suite 228, South San Francisco, CA , 94080 • 1-866-898-6689 • www.halloo.com

Why Deploy a Premise-Based Web Conferencing Solution?

Effective communication is essential to business, and the benefits of Web conferencing extend beyond saving money for travel cost. Companies implementing Web conferencing also appreciate returns in improved communications, productivity and overall efficiency. Companies can now conduct local, national or worldwide meetings to enable greater productivity and cost-efficiency across the entire organization.

Web conferencing refers to innovative technologies that allow people to communicate or "conference" over the Internet. Web conferencing uses the Internet as the means to bring audio, video, and collaboration solutions to PC users anywhere in the world.

Today, companies are faced with two major Web conferencing options:

- A Premised-based solution; this is a software or application solution that is hosted and controlled by the customer. or
- An ASP-hosted solution (application service providers) that are priced on a seat-per-month basis or on a seat-per–minute basis.

Many companies prefer the in-house or premise-based option because of the ability to maintain better control, higher security, and significantly faster ROI when supporting frequent online meetings and eve A premise-based solution is deployed at a comp facility or co-located at an ISP of a company's cho Both internal employees and external meeting at dees are able to access the technology, but the solu is maintained by the in-house IT department remotely by the vendor.

With the constant growth and change of the V conferencing industry, it may seem difficult to a lyze all of the offerings and players availa Businesses face several challenges in selecting right solution and vendor. Some items to consi when evaluating a solution are: cost savings, flexi ity, ease-of-use, security, integration, and scalabi Researching and implementing innovative soluti such as these are essential to continued success.

To read the full report, go to www.technology-reports.com/linktivity.asp

Linktivity is a division of Inter-Tel. Linktivity provides real-time communications and remote control software to enable instantaneo platform independent, browser-to-browser web conferencing and help desk support solutions. The Linktivity family of products includ WebDemo, a Web-based, real-time conferencing and collaboration software tool and WebInteractive, a real-time server software tool th provides Support Professionals with an efficient way to manage and resolve online PC support requirements. http://www.linktivity.co

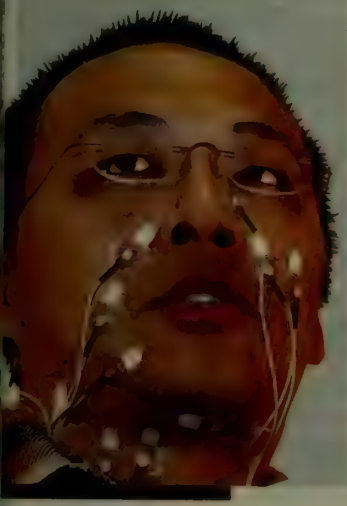
EDITED BY NEIL GROSS

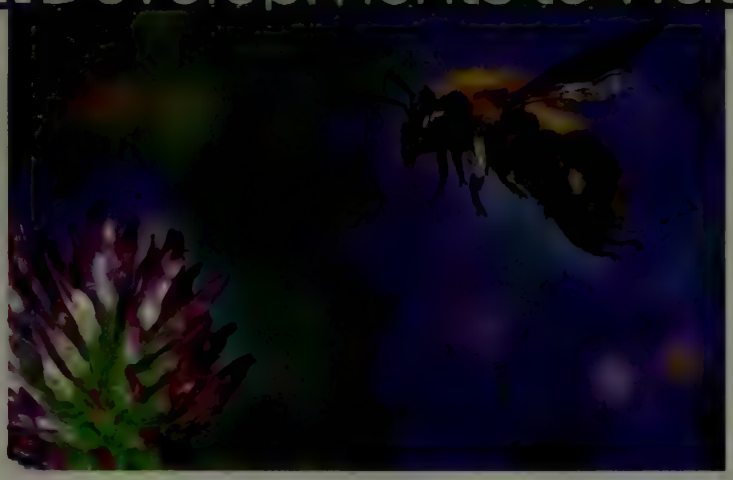
INNOVATIONS

Of blindness and translation

>>Scientists at the Massachusetts Eye & Ear Infirmary believe they have found a link between bacteria and wet age-related macular degeneration (AMD)—the leading cause of blindness in people over 55. The bug, which has also been linked to heart disease, may be a primary cause of eye inflammation. Researchers hope to develop tests to identify patients who are susceptible to the bacterium, and treat them before it can do much damage.

>>Imagine being able to translate a foreign language without actually learning it—or indeed, vocalizing anything at all. Scientists at Carnegie Mellon University and the University of Karlsruhe in Germany are working on technology that can translate one language into another by measuring electrical currents on the surface of the cheeks as speakers mouth words in their native tongues. The system is designed to track muscle movement via electrodes, and then translate the words and speak them aloud. *–Arlene Weintraub*





OPTICS

SIGHT OF THE BUMBLEBEE

BUMBLEBEES MIGHT someday help robots to see better, say ophthalmologists at University College London who are studying how the bees spot nectar-rich blossoms.

Scientists had assumed that bees distinguish one flower from another by adapting to each scene's average color, much like people's eyes adjust when the lights in a movie theater dim. But by setting a swarm of bees loose in a field of plexiglass flowers, the UCL scientists found that the insects homed in on the blue blossoms—the only ones containing nectar—based on how they looked compared to nearby objects. Even when the researchers tried to confuse the bees by shining colored lights on the flowers, the bees always found their target. "The flower doesn't have to look blue, it just has to be bluer than everything else," explains Dr. Beau Lotto of the UCL Institute of Ophthalmology.

UCL researchers are recreating the experiment on computers in the hopes of making software brains that can recognize specific objects in complicated scenes.

–Arlene Weintraub

SECURITY

KNOWING THE REAL YOU BY YOUR WALK

FREQUENTLY WE CAN identify friends just by the way they walk. Researchers have been trying to teach that skill to computers, so that surveillance systems could ID people by their gait. These systems work by matching various measurements, including the distance of the average step and the swing of the legs over intervals of time. Some methods embed sensors under the floor to measure pressure and intervals of walking.

Scientists at the government-run Technical Research Center of Finland have come up with a different use for gait recognition: preventing thieves from walking off with your valuables. The researchers install sensors in objects such as laptops and cell phones, then tune them to the owner's typical acceleration during walking. Your laptop now knows you, and if a thief takes it but fails to mimic your gait, it sends out an alert. Heikki Ailisto, a research professor at the center, admits there are major hurdles. Different shoes, he acknowledges, can alter how we walk. And a phone or laptop in a handbag will move differently from one under your arm.

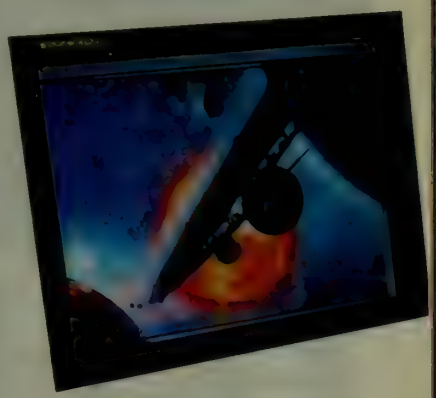
–Catherine Yang

DEPTH VISION

THE BEST 3D GOING—AND NO GLASSES

IT'S NOT QUITE true three-dimensional technology, but it'll do until real 3D displays come along. PureDepth's multilayer displays are double-pane windows made with liquid-crystal displays (LCDs). You can look through the front screen and see what's behind it.

So a surgeon can view images of an internal organ with the patient's vital signs hovering on top. Or video-game software can be modified so objects jump between the front and rear screens depending on their movements within a scene.



There are also versions with up to seven LCDs now being tested by financial analysts, says Fred Angelopoulos, CEO of the Redwood Shores (Calif.) startup.

The technology stems from military research, and the first manufacturing license went to Pentagon supplier DRS Technologies in June. Japan's Sanyo Electric is also negotiating to make displays for gaming and entertainment markets. Consumers can expect to pay about 1.8 times the cost of a regular LCD monitor when the two-layer screens are in volume production.

–Otis Port

(CLOCKWISE L TO R) GLENN H. BROOKES/GLENN BROOKES PHOTOGRAPHY; F. RAUSCHENBACH/ZEFA/CORBIS;

Hedge Fund Sleuths

For sizable fees, they put secretive investment partnerships under a microscope. **BY ANNE TERGESEN**

THE RECENT HIGH-PROfile blowups of two hedge funds, Bayou Management and Wood River Capital Management, have raised an important question: What can hedge fund investors do to avoid getting burned by unscrupulous managers? The answer: Quite a bit, as long as you're willing to spend time or money vetting these investments.

That's not as hard as it may sound. As hedge funds have proliferated, so have resources for checking them out. For fees ranging from $1,000 to several thousand dollars, a growing number of hedge fund "sleuths" will conduct background checks on these secretive partnerships and their managers by searching for such red flags as bad credit histories and padded résumés. And thanks to the dissemination of information on the Internet, individual investors can tap into some of the same tools the professionals

ise. "There's a lot more information available online now than there was just a few years ago," says Jeffrey Brenner, principal at Intelysis, a Cherry Hill (N.J.) firm that does a booming business in hedge fund investigations.

The warning signs that Bayou and Wood River clients missed offer lessons for other investors—many of whom rely heavily on personal recommendations when selecting funds in this clubby world. Among the most important: Verify the manager's credentials and the fund's claims, says Randy Shain, executive vice-president at First Advantage CoreFacts' New York-based investigative unit, which conducts background checks, known as the BackTrack Report. For example, a firm that Wood River named as outside auditor never performed any audit work for the fund, according to the Securities & Exchange Commission. And a lawsuit filed by the Jewish Federation of Metropolitan Chicago on Sept. 2 in U.S. District Court in Connecticut alleges that Bayou founder, Samuel Israel III, "advertised to investors" that he had been a head trader at New York hedge fund Omega Advisors. While employed at Omega, though, Israel had no discretion to call the shots on trades, the suit adds. "There were some major flashing lights," says Leslie Rahl, president of Capital Market Risk Advisors, a New York firm that specializes in hedge fund due diligence, among other things.

TWO TELLTALES

MEANWHILE, WOOD RIVER investors could have spared themselves trouble by turning to the Internet. Indeed, an Intelysis search of various public databases—including those maintained by federal and state criminal, civil, and bankruptcy courts—dredged up enough pre-scandal dirt on the fund and its manager to raise serious concerns. These include a 2002 lawsuit initiated by Wood River's San Francisco landlord for failure to pay rent for three months and a tax lien filed by the state of Idaho on Dec. 1, 2004, for $86,527. "When you see a pattern, it's a warning to steer clear," Brenner says.

Don't think you can rest easy if you invest in a fund of funds, which spreads bets among a diversified array of hedge funds, or if you have a hedge fund adviser. Clients of some prominent hedge fund advisers—including Hennessee Group—were among those burned by Bayou. As a result, it's important to quiz these advisers on how they conduct due diligence on the hedge funds they select, says Chris Cutler, founder of Manager Analysis Services, a New York firm that specializes in hedge fund advisory services. You should also make sure they themselves have clean backgrounds.

If you're thinking about hiring a sleuth, first decide what kind of information you need. Investigative firms, such as Kroll, Intelysis, and First Advantage CoreFacts, perform background checks on funds and their employees. Their fees range from $1,000 to $30,000, depending on the number of funds or managers involved. These firms call former employers, track down credit reports, and contact auditors and administrators to verify that they're on the job. To vet obscure auditors, they research those firms' owners and principals. If a manager has spent time overseas, they'll investigate there.

Other hedge fund advisory services assess whether a fund's investment strategy is right for a client's portfolio and size up the managers' investment credentials. They can use complex statistical tools to predict how a fund will perform under a variety of conditions, says Peter Rajsingh, executive vice-president at vFinance, a diversified financial services firm that invests in hedge funds. They also probe for checks and balances designed to prevent fraud. For example, a fund should employ an outside firm to verify the portfolio's value, says Edward Hawthorne, managing principal at Capco, a New York-based financial-services consulting firm. That's something Wood River did not do, according to the SEC.

A basic step: Check out the manager's résumé

If you don't want to pay investigators' fees, you can take a number of steps on your own. Check whether a manager had run-ins with regulators by perusing Web sites maintained by the SEC and state securities agencies (table). Starting in February, the SEC will require hedge funds with more than $25 million in assets to register with it by filing form ADV. (Some funds do this voluntarily now.) This form lists SEC disciplinary actions against a firm, says Sean Laird, a Philadelphia-based vice-president at PNC Advisors, which works with wealthy clients. Meanwhile, if a manager is registered as a broker with the NASD—or has been registered within the past two years—look up employment and disciplinary records on the NASD site.

To find federal district, bankruptcy, and appeals court records, search PACER, a service sponsored by the federal judiciary that charges 8¢ a page. If you know where your hedge fund manager lives, you may be able to get access to court records in that jurisdiction for free through www.uscourts.gov/courtlinks/. To conduct a more comprehensive search that includes federal and state court documents, you can pay for services such as LexisNexis. On LexisNexis, you can also search for liens and news articles.

For a quick, free search of various public records, go to pretrieve.com. "It won't give you everything, but with one click you can hit a variety of Web sites," says Intelysis' Brenner. A lien against Wood River popped up this way.

Do-it-yourself searches have obstacles. Not all courts publish case information on the Net or through PACER. Private investigators say they sometimes have to visit courts. Moreover, without knowing

Tools of the Trade

lexisnexis.com
A paid service that searches federal and state court cases, plus liens and a database of news reports

www.nasdbrokercheck.com
Compiles employment and disciplinary records of brokers who work for an NASD member firm.

nasaa.org/QuickLinks/ContactYourRegulator.cfm
Links to state securities regulators

pacer.psc.uscourts.gov
Looks up federal bankruptcy, district, and appeals court records, for a fee of 8¢ a page

sec.gov
Includes civil lawsuits brought by the SEC and Form ADV, which contains disciplinary histories of investment advisers

www.pretrieve.com
Provides a quick-hit free search of various public records

www.uscourts.gov/courtlinks
Links to the homepages of federal courts nationwide

your hedge fund manager's past addresses—something private investigators can get through nonpublic databases—you may not hit all relevant jurisdictions. To get your hands on credit reports and verify résumés with past employers and schools, ask the manager to sign a consent form, Brenner advises.

How can you make sure your fund of funds is taking due diligence seriously? Ask to see copies of background checks they've commissioned. They may not let you take them, but you can ask to look them over in the office.

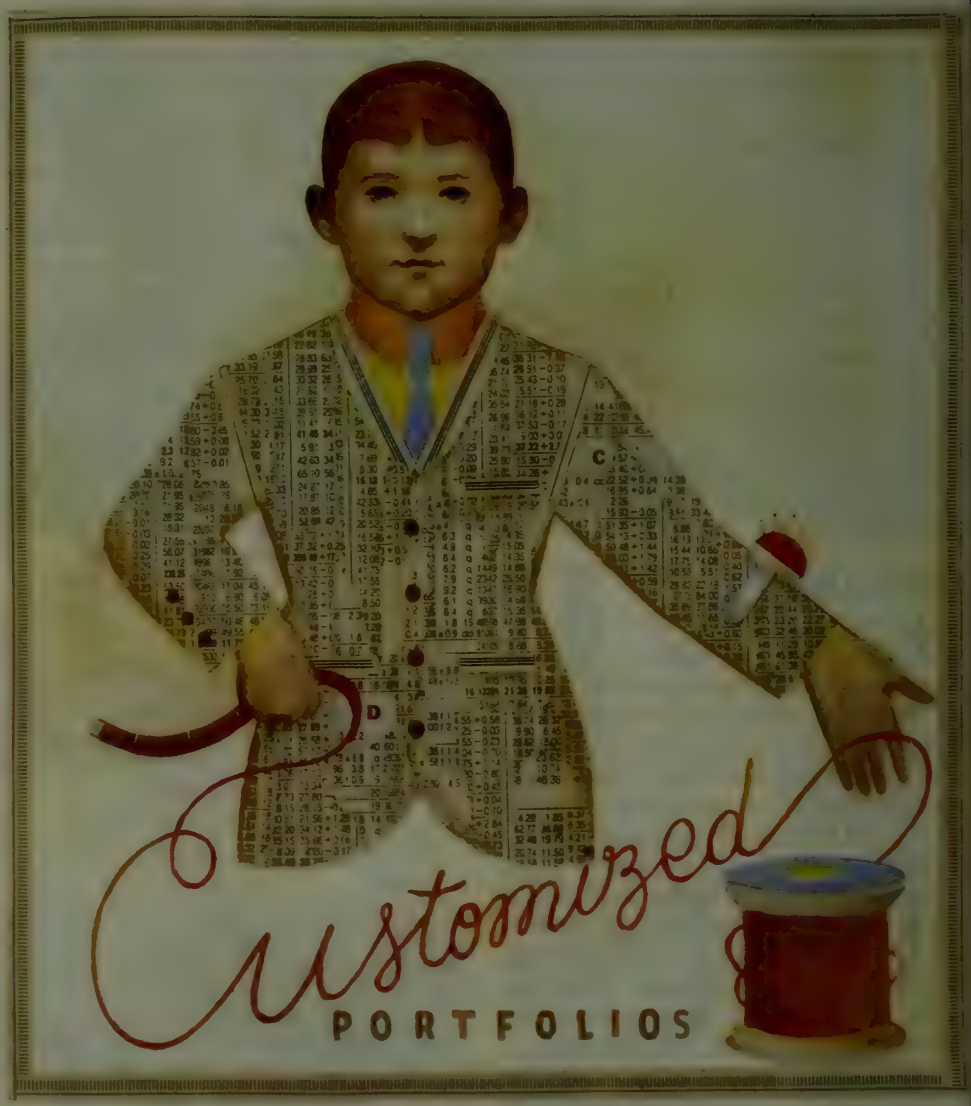
When examining funds, look for policies designed to prevent fraud. Back-office employees—who keep track of investors' money—should report to someone aside from the manager. That way, "if they see anything wrong, they can report it," Rahl says. Ask who has authority to transfer money. "Two signatures are better than one," says Jose Dios, CEO of Global Hedge Strategies, a venture between Citigroup and Pacific Alternative Asset Management Co., an Irvine (Calif.) firm that sponsors hedge funds of funds.

Make sure a fund employs reputable, independent firms to perform audits, prepare client statements, and assign prices to hard-to-value securities, such as convertible bonds. And favor funds that trade through independent brokers. Why? When a fund uses an affiliated broker, as Bayou did, the setup undercuts the fund's motivation to bargain over trading commissions. In the case of a fund of funds, the administrator should calculate the net asset value based on valuation data it receives from the underlying hedge funds—not from the fund-of-funds manager, Dios adds. With professional hedge fund sleuths saying they're finding red flags in about 10% of all due diligence probes, you can't afford not to be vigilant. ■

Investing

Sizing Up Tailored Portfolios

A study shows that investors in separately managed accounts like the results. BY LAUREN YOUNG



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Today, some 2.1 million so-called SMAs command about $613 billion in assets. Mutual funds and hedge funds receive far more attention, much of it unflattering. Still, if you ask the investors who have SMAs how well they like them, you'll find that they're a content bunch.

A soon-to-be-released study commissioned by Citigroup Asset Management found that 90% of the 251 SMA investors polled are happy with their accounts. That's an "off-the-charts" satisfaction rate when compared with other financial products, says Brian Perlman, vice-president at Mathew Greenwald & Associates, which conducted the research for Citigroup. Through its Smith Barney

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unit, Citi is one of the largest purveyors of SMAs.

Yet there is some evidence that SMA investors don't grasp the product's features very well. For instance, what they say they like most about SMAs is something they don't really have: direct access to the people managing their money. "You're not going to have dinner or coffee in Starbucks with portfolio managers," says Peter Cieszko, head of the U.S. retail and high net worth group at Citigroup Asset Management.

In reality, contact with a manager is more remote. Most of the time, the financial adviser at Smith Barney or Merrill Lynch provides information and fields questions about that account. Investors can arrange to get e-mails when a stock is bought or sold as well as invitations to listen in on Webcasts and conference calls with portfolio managers. Citigroup also offers hot lines with recorded updates from managers. Last year the service logged more than 40,000 calls, Cieszko says.

Tips for SMA Investors

NEGOTIATE FEES Don't be afraid to ask for discounts, especially if your account size has grown

MINIMIZE TAXES Use losses to offset any capital gains—in your SMA portfolio or outside of it

DIVERSIFY YOUR PORTFOLIO Compare your SMA holdings with investments outside the account to make sure you are not too heavily weighted in any stocks or sectors

The Citi study also found that SMA investors don't make use of some of the features that distinguish these accounts from mutual funds. Here are some of the key findings:

»TAXES Some 58% of investors polled say they have never instructed their financial adviser to take a gain or loss in their SMAs for tax purposes. That leaves the timing of gains and losses to the portfolio manager who doesn't know investors' particular circumstances—essentially the same as with mutual funds. In promoting SMAs, Wall Street has often highlighted the ability to maximize tax benefits as an important selling point.

> One difficulty: Getting a read on SMA performance as a whole

Why aren't investors using this feature more? In recent years, investors haven't had a lot of gains they needed to shelter, says T.J. Goelz, a financial adviser at Smith Barney in Sarasota, Fla. The Citi study also quizzed 400 financial advisers, and they say that the majority of SMAs they oversee are in tax-deferred retirement accounts, which may explain why their clients aren't worrying about tax issues.

»CUSTOMIZATION Only 52% polled say they have asked their portfolio managers to exclude or include certain stocks. Melissa Gohs, a Morgan Stanley financial adviser in Danville, Calif., has a client who needed some special attention. With more than 100,000 shares of Liberty Media outside his SMA, "he certainly doesn't need any more media stocks," Gohs says. To make sure the client's total portfolio remains diversified, Gohs asked the manager not to invest in any media stocks.

»COSTS In the early days the annual fee on equity-based SMAs was a stiff 3% of assets. That made it near impossible for an account to beat the Standard & Poor's 500-stock index on a sustained basis. But thanks to competition and higher balances, most investors are now paying less than the rack rate—about 2.25%. That's still more than mutual funds, but the gap is narrowing. About two-thirds of SMA investors say they pay fees and expenses that are about the same or less than mutual funds.

»PERFORMANCE Two-thirds of those polled say SMAs outperform mutual funds and stocks. But tracking that performance can be tough. Because the portfolios are tailored for individuals, it's not possible to follow aggregate SMA performance in a newspaper or on a Web site.

»ALLOCATION An SMA alone won't provide all the diversification an investor needs. That's because most SMA managers focus on blue-chip stocks. As such, 40% of the investors polled are using SMAs as core holdings, but 11% are supplementing them with stocks and 35% are using mutual funds to cover such asset classes as small-cap, international, and real estate.

»BEHAVIOR SMA investors think they are more disciplined and more likely to stick to their investment plans than mutual fund customers. "SMAs seem to engender better investor behavior," says Mathew Greenwald's Perlman. The survey doesn't examine the reason why. But Perlman suggests that working with a financial adviser can prevent investors from panic selling in volatile markets.

»ADVISERS Wall Street firms' financial advisers like these accounts, too. Over three-quarters said professional management is the biggest benefit. "The job of picking stocks doesn't fall on my shoulders," says Brady Pringle, an adviser at A.G. Edwards in Tulsa. "That burden falls on somebody who has day-in, day-out experience."

The advisers also say that investors don't understand SMAs as well as they grasp mutual funds. Since these advisers are the intermediaries between the investors and the SMAs, it's clear they have a lot more work to do. ■

Separately Managed Accounts vs. Equity Mutual Funds

	Assets	Average account size	Average expense ratio	Growth rate since 2000†
SMAs	$613 BILLION	$225,000	2.25%	10.3%
Mutual funds	$4.8 TRILLION	$23,400	1.61%	3.9%

*Data for SMAs are account size and expense ratio as of Mar. 31. Other data as of Sept. 30. †Average annual

Data: Cerulli Associates, Citibank, Lipper, Investment Company Institute

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EARLY WARNING A peak-flow meter can show airway narrowing before symptoms appear

How to Manage Your Asthma

Sufferers can achieve "near-perfect" freedom from shortness of breath. **BY CATHERINE ARNST**

IT HAS BEEN A FRUSTRATINGLY intractable problem for asthma specialists. With the advent of long-acting bronchodilators, inhaled steroids, and immune system modifiers, they have the tools in hand to control this chronic, incurable disease that afflicts 20 million Americans. Yet they aren't reaching enough patients.

Asthma accounts for one-quarter of all emergency room visits, is the leading cause of school absences, and is the fourth-leading cause of work absenteeism. The disease kills 5,000 people in the U.S. each year—14 people a day—even though experts say almost all these deaths are preventable. Even more worrisome, the death rate has increased by 50% since 1980 for adults and 80% for children 19 and under. Specialists mostly blame inadequate treatment, usually because patients either are unaware of or lack access to appropriate medical care.

In an effort to improve those grim statistics, the American Academy of Allergy, Asthma & Immunology and two other standard-setting groups recently issued a new set of treatment guidelines aimed at eliminating all asthma symptoms (aaaai.org). Under the old guidelines, established in 1991, patients were classified as having mild, moderate, or severe asthma and treated accordingly. The new system calls for an individualized and frequently modified treatment plan aimed at eliminating wheezing, coughing, chest tightness, and other hallmarks of asthma. "Patients should expect perfect or near-perfect control of their symptoms—and they shouldn't settle for anything less," says Dr. James T. Li, chairman of the division of allergic diseases at the Mayo Clinic and lead author of the new guidelines.

Wheeze No More

Asthma is under control if:

- Symptoms occur twice a week or less
- Bronchodilator medication is used twice a week or less
- Patient doesn't wake up with breathing problems at night or early in the morning
- There are no problems at work, school, or during exercise
- Patient's peak air flow is normal or at a personal best

Data: American Academy of Allergy, Asthma & Immunology

MOVING TARGET

UNFORTUNATELY, RESEARCH shows that most asthmatics settle for far less, in part because they do not understand the severity of their condition. A Harris survey released last spring found that 88% of U.S. asthma sufferers believe their disease is under control. Yet 61% have to catch their breath while running upstairs, 50% have to interrupt exercising because of shortness of breath, and 48% wake during the night as a result of their asthma—all signs of poor control.

Part of the difficulty in keeping the disease in check is that asthma is a constantly shifting target. Allergic triggers, other illnesses, exercise regimens, and stress can change the disease's severity from day to day. "A patient with mild asthma at the beginning of a month could easily have severe asthma by the middle of the month," says Dr. David Rosenstreich, director of the allergy division at Montefiore Medical Center in New York.

Asthma is characterized by overactive immune cells in the airways. When these cells are set off, often by allergic triggers such as house dust, pollen, or animal dander, they cause the air passages to become inflamed. The muscles of the airways tighten, extra mucus is produced and it becomes increasingly difficult for the patient to breathe. Sufferers start wheezing, coughing, and gasping for

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breath; if untreated, a severe attack can lead to death.

To make sure the situation never gets that bad, the new guidelines emphasize treatment goals. The ideal is excellent or total control of symptoms. That means no wheezing day or night, normal lung function, full activity, no nighttime waking, and no need to use short-acting bronchodilators, also known as rescue meds, that dilate the air passages when symptoms worsen.

The first step toward this respiratory nirvana is a continual reassessment of the disease, which means regular consultations with a doctor. At each visit, the physician should get an update of symptoms, sleep disturbance, and how frequently rescue meds are used. Parents of asthmatic children—7% to 10% of all kids—need to be on top of the disease since doctors increasingly think aggressive early treatment can prevent asthma from worsening.

Doctors need to consider more than their patients' words, though. Asthma sufferers should regularly check their lungs' condition at home with a peak-flow monitor. This handheld device, which costs about $25, measures the amount of air a person can expel from the lungs. If airways become narrow or blocked, peak-flow values drop. By keeping a peak-flow chart, sufferers quickly see when their condition is worsening, often before they notice symptoms.

Using this information, doctors can design a treatment plan that incorporates any number of medications. Asthma drugs fall into two groups—those used regularly to prevent attacks by keeping the airways open, such as long-acting bronchodilators and inhaled steroids, and the more powerful rescue medications. Parents should be aware that some studies indicate that long-term use of inhaled steroids might slow a child's growth, but most specialists believe the benefits outweigh any risks.

Just as necessary as a prescription is knowing and avoiding attack triggers. "The most important thing a patient can do is make the bedroom allergen-free," says Rosenstreich. He tells his patients to use allergen-impermeable covers for pillows and mattresses and keep rugs and pets out of the bedroom.

The new guidelines do require active participation by the patient. But given that surveys have found anywhere from 40% to 60% of asthma sufferers limit activities because of their disease, a little effort could go a long way toward improving their quality of life. ■

This Infiniti Is A Big Step Up

Why it beats BMW's 5 Series. BY LARRY ARMSTRONG

THE M45 Its steering makes other luxury cars feel sloppy

FOR INFINITI, THE M series has always been an afterthought, a forgettable, gussied-up Nissan sedan designed to plug the price gap between its flagship Q and its entry-level luxury cars. No more. This time, Infiniti had the benchmark, BMW's 5 Series sedans, in its crosshairs. This Infiniti M is the car the BMW 5 should have been.

I drove the the rear-drive M45 V-8 equipped with the sport package and the V-6-powered M35 with all-wheel drive around Southern California for a couple of weeks. For most people the M35, with its 3.5-liter, 280-horsepower V-6, is plenty, with zero-to-60 times of less than seven seconds. It starts at $41,290, more than $6,000 less than the M45. Another reason to pick the M35, especially if you have to negotiate snowy or wet roads, is that all-wheel drive isn't an option on the V-8.

Both cars are a joy to drive. They're roomy and opulent, and the handling is firm without sacrificing a comfortable ride. The steering is so crisp and precise, it makes the steering on most other luxury cars feel sloppy.

Infiniti didn't stint on interior furnishings, either—a complaint many drivers had about some Infinitis in the past. Versions with the optional sport package have a textured aluminum trim; the others, a gorgeous rosewood across the dash and on the center console. I prefer the wood, and you can substitute it for the aluminum on sport models for $600.

IT FOLLOWS YOUR VOICE

THIS IS A HIGH-TECH CAR, but here, unlike in the BMW, the technology makes sense. Sure, there's the big rotary knob on the dash—it seems almost mandatory on luxury cars—that lets you work your way through a series of menus. But for the most common tasks, such as radio and climate controls, there are buttons as well.

Voice recognition is handy for entering addresses into the navigation system and placing calls on your Bluetooth cell phone. The rear-facing color camera displays a picture of what's behind the car and guidelines that show where the rear of the car is headed. A lane-departure warning, powered by a tiny camera that tracks reflective lane-marking stripes on the road, beeps if you stray—but not if you first telegraph your intent to change lanes with a turn signal.

I've reviewed a lot of cars in the past 15 years, and while Bimmer and Lexus fans may disagree, this Infiniti M is one of the best I've ever driven. ■

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Kicking Back With Calvados

Apple brandy may not have cognac's cachet, but it can reward an adventurous palate. **BY DAVID KILEY**

WHILE MOST OF France obsesses about the grapes, folks in the northwest corner proudly fret over apples. This time of year, as the last of them fall off the trees, distillers in Normandy ruminate about the yield and quality of the fruit they will blend for apple brandy. Named Calvados for a coastal pocket in Normandy, the stuff is worth exploring precisely because of its underdog status in a country whose alcohol economy is steeped in wine.

Calvados is a favorite in France among the working class, probably because orchard owners don't have the snobbish image of winemakers. But the alchemy of Calvados is not unlike that of wine. Calvados makers painstakingly choose and blend dozens of apple varieties—sometimes along with pears—and follow well-guarded recipes of drying and rotting the fruit in flat boxes or right in the grass. They then make cider that becomes Calvados after two distillations and aging in oak. The apples are mostly bitter and acidic, but the subtleties of their flavors are easier to manipulate than those of sweet eating apples.

Age is a big differentiator in picking from among Calvados varieties. Last May I bought a bottle of eight-year-old Calvados in Reims, France, and my Norman friend, Jean-Yves, grumbled: "Too young, too young." But after tasting several brands and ages, I have a difficult time saying "the older the better" across the board.

A TASTE OF NORMANDY
Domaine Dupont's Hors D'Age evokes oaked grapes

Consider the $20 Château du Breuil Fine Calvados from Diageo Château & Estate Wines, blended from brandies aged between two and four years. Finicky Normans might reserve this for cooking sauces, but I liked its buttery feel, taste, and aroma of apples rotting under the tree. Indeed, I didn't care for the eight-year old Reserve du Château as much, as its finish was not as good as the younger brandy.

Calvados Boulard, from Palm Bay Imports of Boca Raton, Fla., also has a range of ages. The $33 Calvados Grand Solage Boulard, a blend of two- to four-year-old brandies, was excellent with a bright apple taste, while the $110 Boulard 1979 had a deeper, oakier flavor, much closer to cognac. It was very good—but, frankly, if I want cognac, I'll pour cognac. Another high-end Calvados, the $100 Michel Huard 1976 from Robert Chadderrdon Selections, unabashedly chases cognac but does retain enough apple essence to keep my senses in the orchard.

The Domaine Familial L. Dupont line of Calvados from Robert Kacher Selections based in Washington, D.C., includes Hors D'Age, $53, aged 10-12 years. Honestly, it reminded me more of brandy from grapes than apples. I preferred the Domaine Dupont Fine Reserve, $38, for its smooth earthier apple flavor.

VOLATILE BREW

I COMPARED THESE brandies with some homemade Calvados produced by a Norman cabinetmaker who would be identified only by his first name to keep the tax collectors at bay. Daniel distills his own Calvados after the production from his 30 trees has been cider for a month or so. His apple potion was a bit raw for me and darn near blew the head off my martini-sipping brothers. Lacking precise production methods, Daniel's results are a bit volatile. But what fun to taste a noble amateur's recipe against the pricey stuff.

Apple brandy must be made in Calvados to carry the name. But it's worthwhile to try some variations from New Jersey distiller Laird, which has been selling apple brandies since 1780. Laird's $65, 88-proof 12-year-old Rare Old Apple Brandy is aged in charred bourbon barrels and thus has the peaty character of whiskey. Its $17 Applejack, made from peak tree-ripened apples instead of the ground-rotted fruit preferred by the Normans, has a polished apple-juice-like essence.

American apple brandy has its place, but I prefer the real thing from France. A.J. Liebling, the American journalist and indefatigable gourmand, wrote in his 1958 book, *Normandy Revisited*, that Calvados "has a more agreeable bouquet, a warmer touch to the heart, and more outgoing personality than cognac." It's true. If a glass of cognac reminds you of a visit to a wealthy French estate, a glass of Calvados is finding out that the conversation is better in the kitchen with the help. ■

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TIME OFF

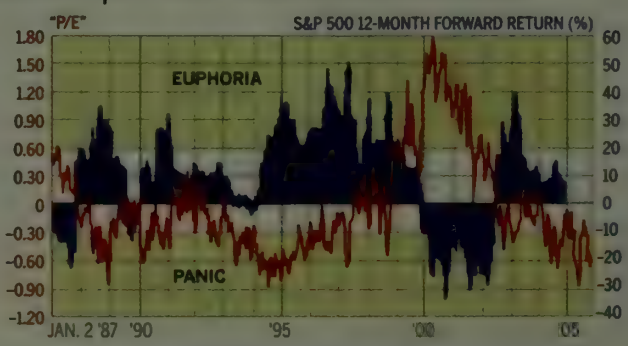
Atlanta by the Sea

MANY CITIES LOOKING to lure visitors have used fish as bait: Nearly half of the nation's 37 aquariums have been built just since 1990. But when the new **Georgia Aquarium** opens its doors on Nov. 23 in Atlanta, it will leave all those other fish tanks gasping for air. Funded largely by **Home Depot** co-founder Bernie Marcus, the $200 million Georgia Aquarium will be the world's largest, with 8 million gallons of water housing more than 100,000 denizens of the sea—everything from beluga whales to hammerhead sharks to sting rays.

From the outside, the aquarium looks like an ocean liner breaking through a wave. Inside, the biggest stars will be two whale sharks named Ralph and Norton. The largest fish on the planet, whale sharks (above) prefer to dine on plankton—unlike their scary, meat-eating brethren—and they have rarely been on display at aquariums outside of Asia. Visitors will be able to view them through a massive, 23-foot-tall by 61-foot-wide window or a 100-foot underwater acrylic tunnel. For ticket information, call 404 581-4000 or go to georgiaaquarium.org. *–Dean Foust*

INVESTING

TO MOST INVESTORS, "p-e" stands for price-earnings ratio. At Citigroup, P/E is a proprietary contrarian stock market indicator meaning Panic/Euphoria. The model includes components such as margin debt and the put-call ratio. When investor sentiment is in the panic territory, as it is now, there is an 80% probability of an increase in stock prices over three to six months, and a 95% probability over the next year.



Data: Citigroup Investment Research, U.S. Equity Strategy

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LUGGAGE

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A STIFF BACK. An aching shoulder. A strap slipping off as you pick up your coffee. These are telltale signs of an overloaded shoulder bag. But while backpacks are more comfortable, they can make professionals feel as if they're back in college. Enter the hybrid **Bumbakpak.** In single-strap mode, it's a shoulder bag with pockets aplenty and thoughtful touches such as a slot to allow for mounting on the handle of rolling luggage. If your load gets heavy, a few adjustments transform it into a low-riding backpack that rests on your "bum" and puts less strain on your shoulders and back. The StreetFlow model (right), which includes a padded laptop compartment, goes for $75 (bumbakpaks.com). *–Adam Aston*

COLLEGE

INSURING THE KIDS' TUITION

NOW THAT'S DESIGNING a financial product to fit a need: Ted Blanch Jr., an insurance executive from Boerne, Tex., wanted to guarantee his grandchildren a college education. So he created an insurance and trust product, backed by several major insurers, that locks in four years of tuition (with or without room and board) for any school at a slight premium to today's prices for a private university.

Available for children newborn to age 5 only, the policy requires either a lump sum payment or installments over seven years. A healthy middle-aged couple would pay about $141,000 now to cover all college costs. On the payment plan, it's about $21,000 more. You can get more details about the policy at securededucation.com. *–Lauren Young*

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is like asking a father to play FAVORITES. *In*

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EIGHTEEN *is* FIRST *in line for the* INHERITANC

After 18 *years it is especially* HARD *to let go. Time and again* JIM CRYLE *rises to the* CHALLENGE. *He watches his whisky MATURE for eighteen years,*

then sends each BOTTLE *Selfless actions from a so so you can taste the* EXCE *is the* SINGLE MALT *that*

SINGLE MALT SCOTCH WHISKY

GUARANTEED **18** YEARS

THE SINGLE MALT THAT STARTED IT ALL.

BY GENE G. MARCIAL

WACHOVIA MAY BID ON CREDIT-CARD BEHEMOTH CAPITAL ONE.

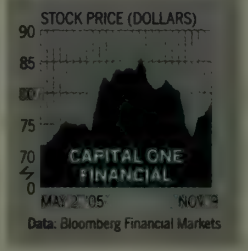
UNITED TECHNOLOGIES IS OUT OF FAVOR—AND GOING CHEAP.

THE MARKET IS GROWING FOR SALIX' GASTROINTESTINAL DRUGS.

CapOne and Wachovia?

CAPITAL ONE FINANCIAL (COF), the No.1 independent credit-card issuer, may be the next buyout in consumer lending. MBNA was tops—but was bought in July by Bank of America. With the merger, MBNA ended its banking ties with Wachovia, which has decided to get back into the lucrative credit-card trade. That's fueling new Street whispers that Wachovia may go after CapOne. Craig Maurer, managing director at Fulcrum Global Partners, says that when MBNA cut its link with Wachovia, speculation swirled that CapOne could be a target, with Wachovia as the logical buyer. Rather than building from scratch, it's likely, says Maurer, that Wachovia will buy CapOne, which has 48 million customers and $81 billion in managed loans outstanding at the end of 2004. (Wachovia has a small credit-card portfolio, which is still managed by MBNA. But many expect the relationship to end.) A minimum bid that CapOne CEO Richard Fairbank might take to the board, says Maurer, is 13 times 2006 earnings—equal to what MBNA got. That's $103 a share for CapOne. Its stock slumped in early October—from 80 to 72—in part because of a rash of bankruptcy filings to beat the new bankruptcy law. It's rebounded to 78. Mark Hebeka of Standard & Poor's, who rates CapOne a strong buy, says the stock doesn't yet reflect the company as a "viable acquisition candidate." He expects it to earn $7 a share in 2005 and $7.94 in 2006, vs. 2004's $6.21. Wachovia and CapOne did not return calls.

HIT BY LOTS OF BANKRUPTCIES

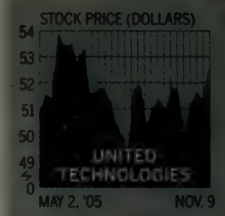


Data: Bloomberg Financial Markets

United Technologies: Going Up?

ALL YEAR, SHARES of United Technologies (UTX) have been locked in a tight range of 49 to 54—in part because the company is a conglomerate. Once the darling of investors, the group has long been out of favor. With the stock now at 52, or 14 times 2006 estimated earnings of $3.50 a share, it trails its peers. This is an "attractive entry point to a stock worth 60," argues Owen Fitzpatrick of Deutsche Bank Private Banking, which owns shares. He notes that its major units are leaders in their fields: Pratt & Whitney, one of the Big Three jet-engine makers, accounts for 29% of total sales and 34% of earnings; Otis Elevator, tops in lifts and escalators, pulls in 24% of sales and 34% of profits; and air-conditioner and heater leader Carrier kicks in 29% of sales and 20% of profits. Fitzpatrick sees a continued rise in aerospace and solid gains at Otis and Carrier. Also high on UT is Steve Binder of Bear Stearns—which has done banking for UT—who rates it "outperform." He sees profits of $3.11 a share in 2005 and $3.50 in 2006, up from $2.65 in 2004. The best barometer of the health of UT's core businesses is free cash flow: $906 million in the third quarter vs. $741 million a year ago, says Binder.

STATIC FOR TOO LONG

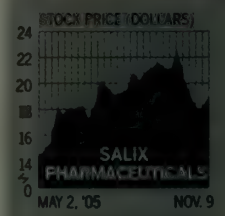


Data: Bloomberg Financial Markets

Salix Pharmaceuticals: What the Gut Tells You

SALIX PHARMACEUTICALS (SLXP) is the small fry in gastrointestinal drugs, with Johnson & Johnson and GlaxoSmithKline the biggies. But Salix is a pure play in that growing market, says Peggy Farley of Ascent Capital Management, which owns shares. Its chief product, Colazal, treats colitis—inflammation of the colon. Its other drug, Xifaxan, is for travelers' diarrhea. On Oct. 3, Salix completed a purchase of InKine Pharmaceutical, whose products diagnose and treat stomach ills. InKine's new drug is a tablet used prior to colonoscopy. Farley says InKine should add at least $60 million to Salix' revenues and 2¢ a share to earnings. On Nov. 8, Salix posted third-quarter results that beat analysts' forecasts, driving the stock up from 17.40 to 19.44 that day. Farley sees the stock at 24 by the end of 2005 and 36 in 12 months. Deborah Knobelman of Piper Jaffray just raised her 2005 earnings estimate from 61¢ to 69¢ a share on sales of $151 million, including InKine's sales. In 2004 it earned 18¢ on sales of $105 million. ■

THAT FULL FEELING



Data: Bloomberg Financial Markets

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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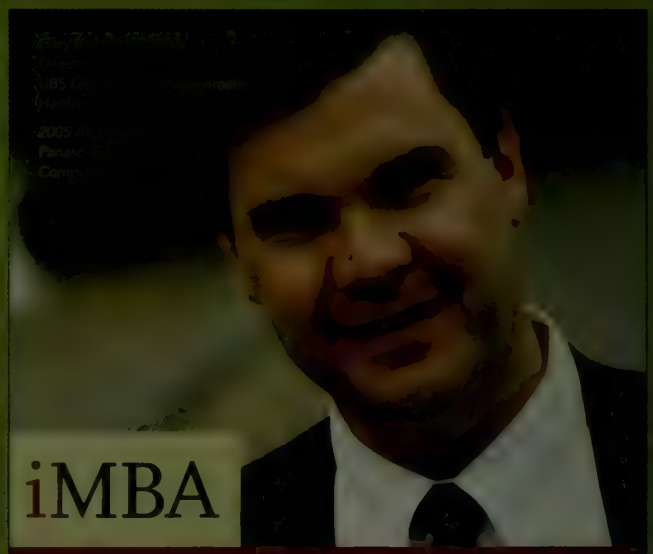

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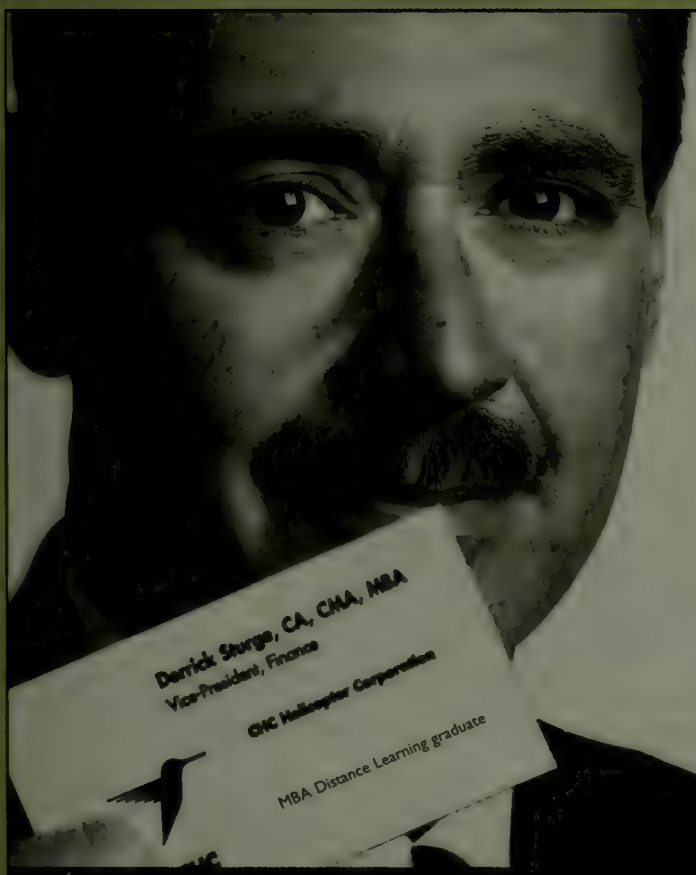

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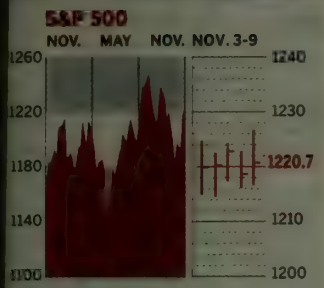
STOCKS



COMMENTARY

Although stocks rose four out of five sessions, there were some trouble signs. Luxury-home-builder Toll Brothers cut its '06 sales forecast, suggesting Fed rate hikes are finally having an impact on the torrid real estate market. Another worry: Foreign appetite for U.S. T-bills is slackening, as foreigners shied away from a Nov. 9 Treasury auction. On the plus side, oil fell.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	NOV. 9	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1220.7	0.5	0.7	4.9
Dow Jones Industrials	10,546.2	0.7	-2.2	1.5
NASDAQ Composite	2175.8	1.5	0.0	6.5
S&P MidCap 400	713.6	0.1	7.6	15.1
S&P SmallCap 600	345.0	-0.1	4.9	11.7
DJ Wilshire 5000	12,200.4	0.5	2.1	7.2
SECTORS				
BusinessWeek 50*	734.1	-0.2	4.2	9.5
BW Info Tech 100**	369.3	1.0	-1.1	5.1
S&P/BARRA Growth	584.2	0.8	0.4	3.7
S&P/BARRA Value	632.2	0.2	1.1	6.0
S&P Energy	366.4	-2.3	26.9	32.1
S&P Financials	414.6	0.9	0.8	5.3
S&P REIT	147.8	0.3	2.3	9.7
S&P Transportation	237.7	0.9	-1.6	2.6
S&P Utilities	157.3	0.1	11.1	14.4
GSTI Internet	192.5	0.9	8.0	20.4
PSE Technology	819.5	1.5	5.2	11.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	NOV. 9	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1413.1	-1.3	1.1	9.9
London (FT-SE 100)	5439.8	1.5	13.0	15.3
Paris (CAC 40)	4480.2	1.1	17.2	18.8
Frankfurt (DAX)	5011.4	1.1	17.7	23.3
Tokyo (NIKKEI 225)	14,072.2	1.3	22.5	28.3
Hong Kong (Hang Seng)	14,597.6	0.0	2.6	8.0
Toronto (S&P/TSX Composite)	10,656.5	0.7	15.2	20.5
Mexico City (IPC)	15,981.2	0.5	23.7	35.6

FUNDAMENTALS	NOV. 8	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.06%	2.06%	1.65%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.8	17.7	19.8
S&P 500 P/E Ratio (Next 12 mos.)*	14.5	14.3	16.4
First Call Earnings Revision*	-1.51%	-1.42%	-0.16%

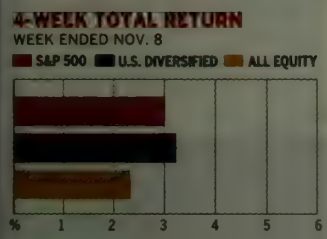
*First Call Corp.

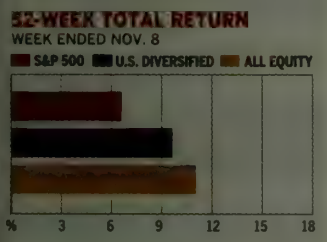
TECHNICAL INDICATORS	NOV. 8	WEEK AGO	READING
S&P 500 200-day average	1200.5	1199.3	Positive
Stocks above 200-day average	54.0%	49.0%	Neutral
Options: Put/call ratio	0.70	0.79	Positive
Insiders: Vickers NYSE Sell/buy ratio	2.93	3.18	Negative

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Motorcycles	15.5	Oil & Gas Refining	91.2
Constr. & Engineering	14.7	Oil & Gas Drilling	61.2
Aluminum	13.6	Oil & Gas Exploration	53.8
Home Entertainment	13.2	Constr. & Engineering	53.1
Internet Software	10.7	Managed Health Care	52.9

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
IT Consulting	-18.6	IT Consulting	-47.9
Automobiles	-13.0	Automobiles	-40.8
Constr. Materials	-8.9	Photographic Products	-28.3
Commercial Printing	-8.6	Home Furnishings	-27.0
Oil & Gas Storage	-8.2	Auto Parts & Equip.	-22.8

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Financial	6.1	Latin America	67.1
Technology	5.0	Natural Resources	41.1
Japan	4.4	Diversified Emerg. Mkts.	32.6
Large-cap Growth	4.2	Diversified Pacific/Asia	25.7
LAGGARDS		**LAGGARDS**	
Precious Metals	-3.8	Precious Metals	3.6
Pacific/Asia ex-Japan	-3.2	Domestic Hybrid	5.7
Utilities	-2.4	Miscellaneous	6.7
Europe	-1.6	Large-cap Blend	7.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Berkshire Focus	13.5	iShares MSCI Brazil Idx.	76.4
ProFunds Internet Inv.	11.8	T. Rowe Price Lat. Am.	74.0
Rydex Dyn. Veloc. 100 H	11.3	iShares S&P L. Am. 40 Idx.	70.7
ProFunds UltraOTC Inv	11.2	Merrill Lynch Lat. Am. C	69.7
LAGGARDS		**LAGGARDS**	
American Heritage Grth.	-20.0	Ameritor Investment	-60.9
American Heritage	-11.1	American Heritage Grth.	-42.9
ProFunds UltSh. OTC Inv.	-10.6	American Heritage	-27.3
Rydex Dyn. Vent. 100 H	-10.5	ProFds. USh. Mid Cap Inv.	-24.7

INTEREST RATES

KEY RATES	NOV. 9	WEEK AGO	YEAR AGO
Money Market Funds	3.48%	3.43%	1.36%
90-Day Treasury Bills	3.96	3.93	2.06
2-Year Treasury Notes	4.49	4.43	2.82
10-Year Treasury Notes	4.64	4.61	4.23
30-Year Treasury Bonds	4.84	4.80	4.95
30-Year Fixed Mortgage †	6.31	6.19	5.69

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.98%	4.59%
Taxable Equivalent	5.69	6.56
Insured Revenue Bonds	4.08	4.60
Taxable Equivalent	5.83	6.66

THE WEEK AHEAD

RETAIL SALES *Tuesday, Nov. 15, 8:30 a.m. EST* » October retail sales are forecast to have fallen 0.2% and purchases minus autos very likely rose 0.4%. That's the median forecast of economists polled by Action Economics. In September sales rose 0.2%, and jumped 1.1% less vehicle sales.

PRODUCER PRICE INDEX *Tuesday, Nov. 15, 8:30 a.m. EST* » Producer prices most likely retreated 0.2% in October, after a 1.9% jump. Excluding food and energy, prices probably grew 0.3% for a second straight period.

CONSUMER PRICE INDEX *Wednesday, Nov. 16, 8:30 a.m. EST* » Consumer prices for goods and services probably eased 0.1% in October. Excluding food and energy, prices likely nudged up 0.2%. In September prices surged 1.2%, and core inflation rose 0.1%.

RESIDENTIAL CONSTRUCTION *Thursday, Nov. 17, 8:30 a.m. EST* » Housing starts likely eased to an annual rate of 2.05 million in October, from 2.11 million in the prior period.

INDUSTRIAL PRODUCTION *Thursday, Nov. 17, 9:15 a.m. EST* » October factory output most likely grew 0.6%. In the prior month production fell 1.3% due in large part to a 9.1% plunge in mining output. The average monthly operating rate is forecast to have climbed to 78.8%.

The *BusinessWeek* production index edged up to 259.2 for the week ended Oct. 29, a 12.4% increase from a year ago. Before calculation of the four-week moving average, the index edged down to 260.9.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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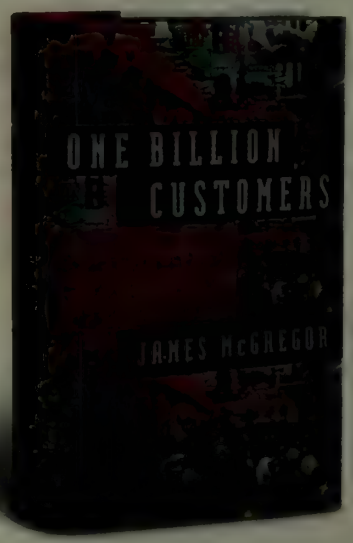
The Art of the Chinese Deal

ONE BILLION CUSTOMERS Lessons from the Front Lines of Doing Business in China
By James McGregor; Wall Street Journal Books; 336 pages; $27

The title of James McGregor's book tells you precisely what you're getting. *One Billion Customers: Lessons from the Front Lines of Doing Business in China* is his engaging account based on almost two decades of experience—as China bureau chief of the *Wall Street Journal*, head of Dow Jones China business operations, chairman of the American Chamber of Commerce in China, and partner at a China-focused venture-capital firm. Like the best China business books, including Jim Mann's *Beijing Jeep* and Tim Clissold's *Mr. China: A Memoir*, McGregor's volume is both colorful and cautionary, offering sound prescriptions for Westerners.



One Billion Customers begins with a good historical overview, starting with Britisher Lord George Macartney's 1793 arrival on the Chinese coast, as he sought to crack open the prosperous but insular nation. A whirlwind tour of China's past brings the reader up to China's 2001 entry into the World Trade Organization. McGregor uses his close contact with key players—in this case, Charlene Barshefsky, former head of the Office of the U.S. Trade Representative, and chief China negotiator Long Yongtu—to nail the hidden story of the down-to-the-wire negotiations that brought about this seminal event.

Throughout, McGregor provides practical advice: Each chapter ends with a section called "The Little Red Book of Business," a play on Mao Zedong's Little Red Book. After a description of China's economic opening, he writes: "Chinese negotiators are masters of making you feel you need them more than they need you"—advice as useful for a potential U.S. investor as for a U.S. trade negotiator. Then he observes: "The Chinese try to play you as being 'unfriendly' to China if you don't give them what they need. Don't be afraid to tell them that friendly business is based on a fair deal for all."

McGregor keeps things lively by recounting the experiences of Western and Chinese businesspeople, officials, entrepreneurs, journalists, and the occasional crook. He introduces people like the power couple Zhang Xin and Pan Shiyi, two real estate magnates, and the wily former telecom czar Wu Jichuan. The latter tried to stymie the rise of telcos such as UTStarcom Inc. and to control foreign investment in the Internet. Then there's the saga of Rupert Murdoch's attempt to enter China's media market, and the story behind the rise of his business partner Liu Changle, a former army officer. These tales provide a window onto the creation of China's only 24-hour news station and the beginnings of a more independent press. Still, McGregor warns: "Objective news is making progress when it serves the interests of the state, but don't expect a free press in China in your lifetime."

I particularly enjoyed reading about the former head of China Construction Bank, Beijing Mayor Wang Qishan. The author recounts Wang's jousting with Morgan Stanley Asia's former chairman, Jack Wadsworth—and how ultimately, the two created China's first joint venture investment bank, CICC. While some of the friction in this undertaking was likely due to the egos of the two titans, McGregor points to a deeper problem: the tendency of Chinese partners to have a skewed vision of who should benefit. "Avoid joint ventures with government entities unless you have no choice," he advises, "then understand that this partnership is about China obtaining your technology, know-how, and capital while maintaining Chinese control."

McGregor warns that the investor may also face the real danger of getting "caught in the crossfire" of the often fractious political relations between the mainland and the U.S. This is a risk for any company given American concerns about job losses, the swelling trade deficit, and the value of the yuan—and an even bigger danger for technology companies vulnerable to accusations that they are building China into a tough rival of the U.S.

There is some comfort for those who fear that China is an unstoppable juggernaut. McGregor notes that China's rote education system has produced a strong workforce but "too few innovative business leaders and line managers capable of building the large organizations that will take China business global." And when a powerful leader emerges, such as Zong Qinghou, founder of Chinese beverage maker Wahaha Group, too often there are no competent successors. The problem is China's system of "top-down management under a benevolent dictator," writes McGregor. The jury is out, he writes, on how well the Lenovo Group-IBM alliance will meld its very different corporate cultures.

> A savvy piece of advice: "Avoid joint ventures with government entities"

The China dreams of many foreign investors might end badly, as the author's tales attest. But China's market is likely to retain its allure. Those coming to seek fortunes would be well advised to bring McGregor's *One Billion Customers* with them. ■

–By Dexter Roberts

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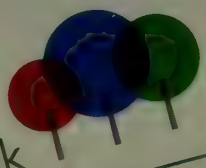

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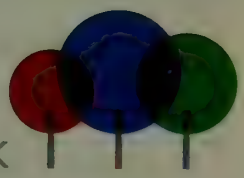

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WITH MARIA BARTIROMO

Hank Greenberg Opens Up

AT MY LUNCH with Hank Greenberg recently, the former chairman and CEO of American International Group talked about what he has been doing since stepping down and his plans to reinvent himself. He told me, among other things, that he's part of a group investing in embattled broker Refco Inc. Then, hours before he jetted off to Asia for a business trip, I visited him in his new New York office, decorated with photos of Hank with Asian leaders and a picture of his dog, Snowball.

Let's try to talk as specifically as you can, Hank, about what you're doing with your investments and where you're investing.
CV Starr & Co. and Starr International Co. [are] invested in private equity and are co-investing with others; commitments of about $400 million dollars so far. Starr money is being invested in both the U.S. and a number of countries in Asia.

I am also looking at Eastern Europe—you know, emerging markets where the population and per capita [income] is increasing. They want to buy washing machines, they want to buy TVs. They need help in financing these things, so consumer finance would be a growing business for many parts of the world.

Do you think China will at some point become the world's largest economy?
Unless they stumble, absolutely.

How do you feel about AIG, the company you built?
It's a great company. I took [it] from $300 million market value to about $160 billion. I don't think it's been done [before]. Look, it's the largest insurance company in history—in history.

So you plan to bring CV Starr to the size of AIG?
Could be. I think big, Maria.

Can you talk about AIG's board pushing you out?
I can't comment on that. I'd love to. There will be a day when I can, but it's not today.

SNAPSHOT

FOR ALMOST 40 YEARS, Maurice R. "Hank" Greenberg, chairman and CEO of American International Group, was the most powerful force in insurance. After allegations of **accounting fraud at AIG**, he was forced out in March. Greenberg, 80, still controls three private entities that have a **substantial position** in AIG stock—CV Starr & Co., Starr International Co., and the Starr Foundation. And he still seeks **new business ventures**—especially in Asia, where he wields considerable influence.

Stories came out about the board withholding personal items of yours. Why would they withhold them, and did you get everything back?
I don't think I've gotten everything back...there are many things missing. There is a table that has very sentimental [meaning] to me, and I want it back. Why did they do that? There is no rational reason that I can come to. I led AIG for about 38 years. I would have thought I'd be entitled to my personal things.

You transferred [AIG stock then valued at $2.2 billion] to your wife [just before you resigned], and you took it back [a short while later]. Why did you do that?
There were some estate planning things, and I decided there was such a fuss about it. [Plus] it wasn't working.

Was she upset?
No, not at all.

But you had to cook dinner a few nights, right?
Yeah, I was getting home earlier. (Laughs)

Do you feel your friends stayed with you, colleagues in business stayed with you, during what has to be the toughest period in business for you?
You know, Maria, that is a very good question. You'd be surprised what you learn about people when you have an incident arrive like it did last year. Many friends did stand by me, and some very good friends were silent. You really find out about people when [situations like that] occur.

Do you speak to those people who stayed silent?
Not if I can avoid it.

Has this crisis brought the Greenberg family closer?
Oh, yes, it has. It has brought us all very close.

These have obviously been tough years, and some of your friends have been shocked. Have you done anything wrong?
Absolutely not.

Maria Bartiromo is the host of CNBC's Closing Bell.

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BY BRUCE KATZ

A Disturbing Disarmament

Urban poverty has always been one of America's open secrets, only vaguely acknowledged until events like Hurricane Katrina bring it to the fore. At such times there is often much discussion but few solutions. Yet, despite the hand-wringing, this nation actually has a number of proven market-based tools to fight poverty, especially in neighborhoods where it is concentrated. Strangely, these tools have been repeatedly under attack by the Bush Administration and survive due to rare bipartisan support in Congress.

Although the worst days of urban decay have passed, nearly 8 million people still live in about 2,500 city neighborhoods where more than 40% of the residents are poor. These places are stratified by race as well as class. In cities as diverse as Cleveland, Miami, New York, Atlanta, Los Angeles, and pre-Katrina New Orleans, more than 30% of poor blacks live in neighborhoods of severe economic and social distress.

Residents of these communities face daunting obstacles: failing schools, unsafe streets, run-down housing, and few local jobs. But there is also a huge cost that extends far outside these pockets of poverty. Cities are forced to pay for the higher costs of delivering health, education, police, fire, judicial, and other services in high-poverty environments, often amounting to hundreds of dollars annually per city resident. With higher expenses come higher taxes, inhibiting cities' ability to attract and retain middle-class families, the backbone of resilient economies. And the concentration of neighborhood poverty leads inexorably to the concentration of poor children in neighborhood schools, undermining almost every other public or private effort to educate them.

Funding cuts threaten proven weapons in the war on poverty

BUT THE GOOD NEWS IS that concentrated poverty is not intractable. During the 1990s the federal government made huge progress breaking up the concentration of poverty through several bold actions. A twin focus on housing and work drove these results.

In cities like Atlanta, Louisville, and St. Louis, the $6.5 billion federal HOPE VI program literally demolished the worst public housing projects—think the bleak high-rise warehouses of poverty built in the 1950s—and replaced them with new, economically integrated developments. These complexes have sparked a mini-revival in many inner cities, unleashing new private investment in business and housing.

The past decade also witnessed substantial growth in the use of housing vouchers. Studies show that children and adults who use vouchers to move to areas of lower poverty have better access to good schools and jobs and get an almost immediate improvement in mental and physical health.

Finally, to reward work the federal government in 1993 doubled the Earned Income Tax Credit (EITC) for low-wage households, lifting millions of workers out of poverty and strengthening neighborhoods with minimal bureaucracy.

These efforts use the market to drive wealth creation, neighborhood renewal, and business expansion. The best of the HOPE VI projects were privately built and remain privately managed, providing real marketplace consequences should they fail. Housing vouchers enable low-income families to choose where to live in the private rental market, rather than being consigned to dysfunctional areas. And the EITC, only received by those who work, was Ronald Reagan's favorite antipoverty program.

Despite these conservative credentials, the Bush Administration has withdrawn support for all three initiatives as part of a broader effort to cut spending. Funding for the HOPE VI program was drastically cut—to just $150 million annually, down from $600 million—after the White House called for its elimination. Likewise, funding for additional vouchers has been reduced, and the Administration proposal to devolve the program to the states would further undermine this proven tool. There are even proposals to limit access to the EITC.

This is the wrong path. We need to restore funding for these programs and policies with a track record of rewarding work, promoting housing choice, and encouraging mixed-income neighborhoods. We also need to embrace innovations, like the President's call for the creation of a home ownership tax credit, a vehicle that could spur the market for moderately priced occupant-owned housing in cities. We know how to reduce concentrated poverty in America. And we can do it in a market-based way that leverages public dollars for national gain—but only if Congress and the President work together. ■

Bruce Katz *is a Vice-President at the Brookings Institution and Founding Director of its Metropolitan Policy Program.*

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HE MAN WHO INVENTED MANAGEMENT

Peter Drucker: Why his ideas still matter

BY JOHN A. BYRNE (P.56)

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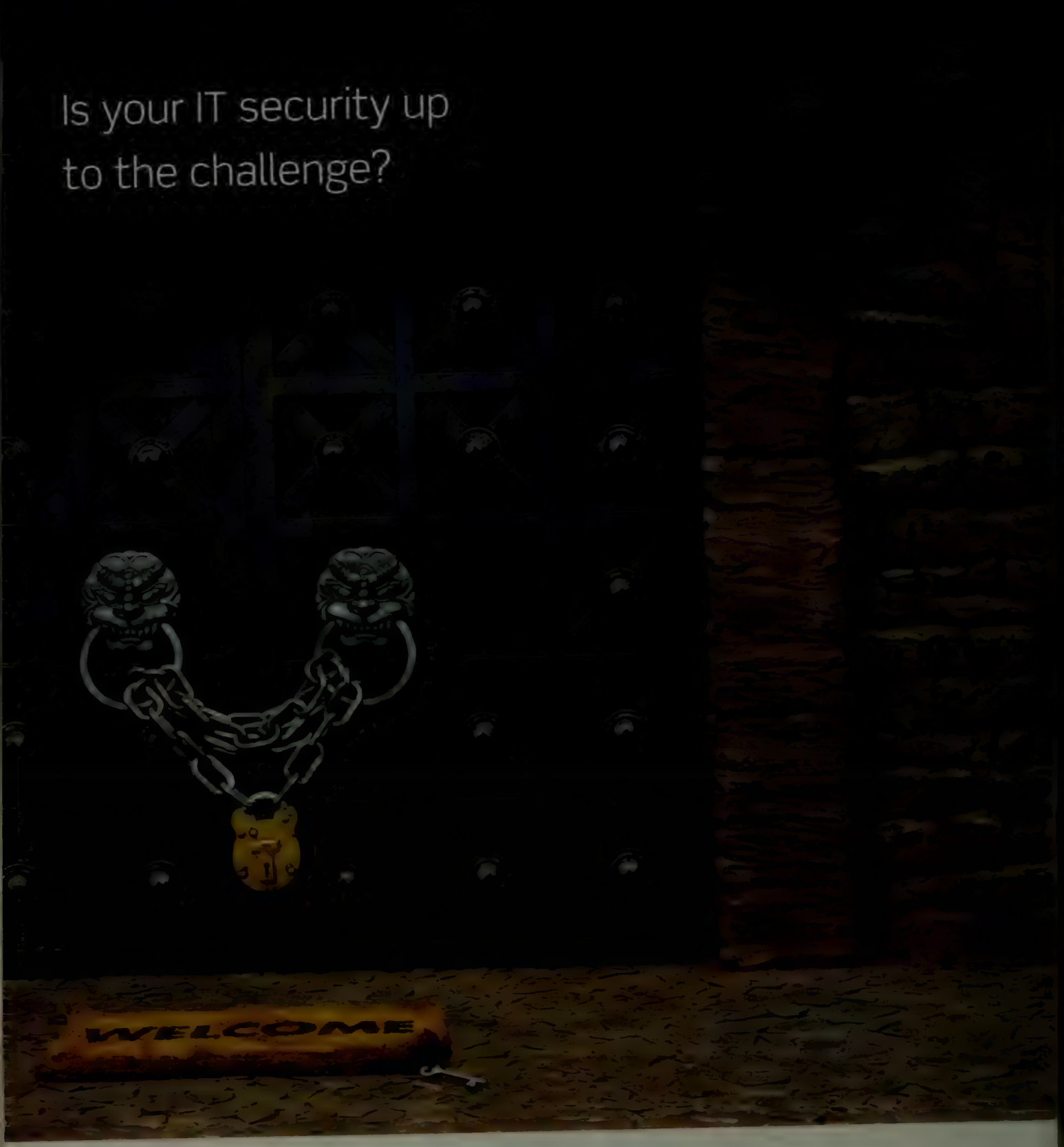

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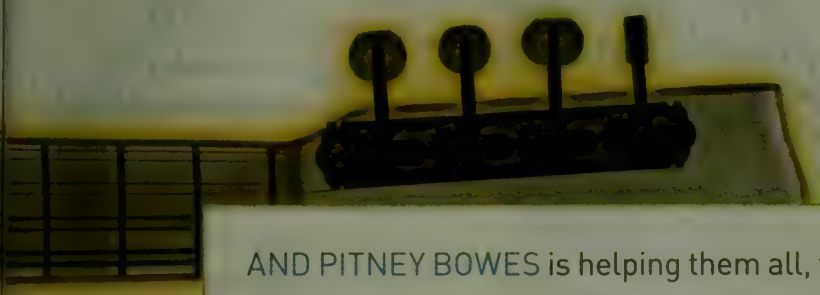

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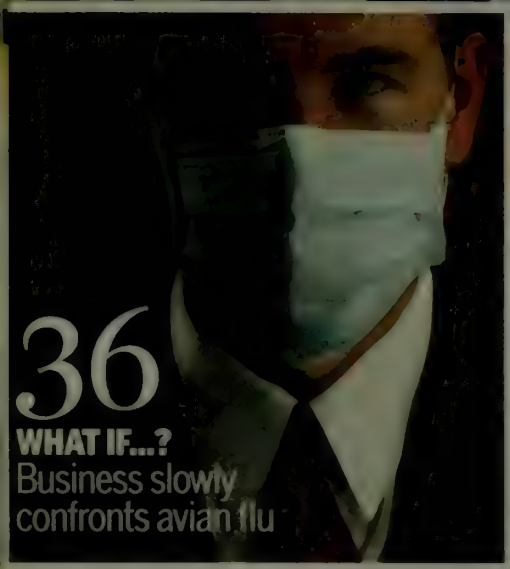
TAKING STOCK

"I helped a few good people be effective in doing the right things." Why Peter Drucker's ideas still matter



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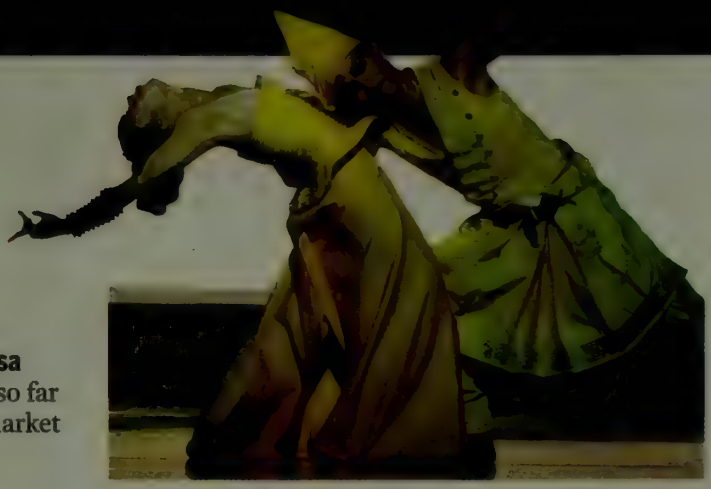

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- THE WALL STREET JOURNAL

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE*	OUR AWARD
TOP 3 GINS	
Hendrick's $30/750ml	Most Flavorful
Tanqueray No. Ten $26/750ml	Smoothest
Juniper Green Organic $26.50/750ml	Best Presentation

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Looking for a Dream Home You Can Afford in Real Life?

Sure, prices have rocketed in recent years, but over the past several weeks, we've gone in search of pockets of affordability across America, **where nice homes can still be bought for under $500,000.** And we found plenty, usually in smaller cities or in suburbs that are 60 to 100 km outside town. We've assembled these gems in a series of **slide shows by region** featuring the likes of a four-bedroom, 230-sq.-m home in Phoenix (right) for $489,900. In all, we have dozens of great, affordable homes on display. Enjoy

Strong Buys in a Wary Investing Season

Although long-term factors suggest it's time to play defense, S&P has more than 100 stocks with its highest rating, says Chief Investment Strategist Sam Stovall. See what he recommends in this Q&A

The Next Chapter in Gateway's Turnaround Tale

Having slashed costs and nabbed retail share, CEO Wayne Inouye is now going after big customers—he's also asking investors to be patient. This analysis explains why that may be a reasonable strategy

Architectural History Lives in Glass Houses

An inside look at legendary architect Philip Johnson's final project, the Urban Glass House in New York—already positioned to be an historic landmark

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UPFront

"[Their] first English word will be 'Google.'"

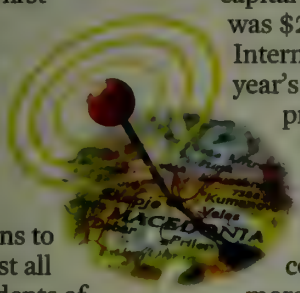
–MIT prof Nicholas Negroponte, to The Washington Post, *on the impact of a $100 laptop Massachusetts Institute of Technology is developing for kids in poor countries*

DITED BY DAN BEUCKE

WI-FI WORLD

WIRELESS HEADS FOR THE HILLS

HE REPUBLIC OF MACEDONIA, nown primarily as the outhern leg of the country ormerly known as ugoslavia, may soon become nown as the first Vi-Fi nation. n Nov. 21, Iacedonian Iet service rovider **n.Net** is xpected to nnounce plans to onnect almost all million residents of he ancient mountainous ountry with a Wi-Fi network tretching across 30 cities nd spanning more than ,000 square miles. To put hat in context, imagine ountless **Starbucks** hotspots laced back to back. "The Iacedonia project validates Wi-Fi as a serious contender to cellular networks," says Esme Vos, founder of **MuniWireless.com** and an expert on municipal Wi-Fi.

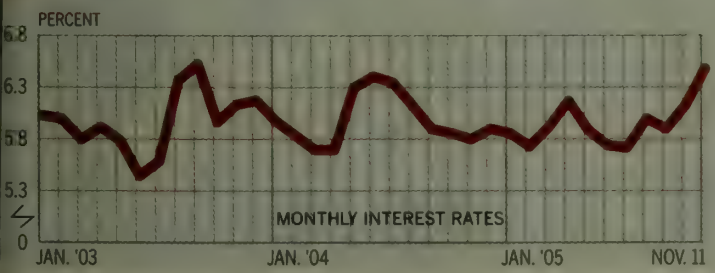


The zippy service will sell for about $18 a month, vs. the $47 consumers now pay for far slower service from the incumbent phone company. That offer, in a country where 2004 per capital gross national income was $2,350, will help push Internet usage from last year's 2.5% to 30% by 2007, predicts On.Net CEO Predag Cemerikic, 39. He started On.Net in 2005 after running a broadcast TV company. "We need a more affordable solution," he says. With equipment from U.S.-based **Strix Systems,** On.Net has already set up Wi-Fi across the capital of Skopje, home of half of Macedonia's population. It expects to reach most of the nation in six months.

–Catherine Yang

THE BIG PICTURE

LOW NO MORE Average rates for a 30-year fixed-rate mortgage are at the highest in more than two years, one reason why U.S. home sales are slowing.



Data: HSH Associates

CHAT ROOMS

Psst! Wanna Hack Into PayPal?

COMPUTER HACKERS HAVE a clever new way to dodge crime fighters. They're taking over poorly monitored chat rooms and message boards at public Web sites and using them to hawk stolen IDs, credit-card numbers, and malicious software. Hackers are responding to cops' and cyber-security firms' scrutiny of underground trading sites. "They are using these message boards as a place to communicate that may not be on the radar," says an FBI cyber-crime analyst.

Bad guys pop up in the darnedest places. At **BeatSoup.com**, the site of a Boston ska band, the chat room has dozens of sleazy ads, including a Nov. 12 post from infernohackware offering to sell software code for $50 to break into **PayPal** accounts. The site's administrator didn't respond to requests for comment. Even on **Policefamilies.com**, run by the Nashville police department, a kids' message board contains postings for stolen bank-account data. Access to the board was blocked in September. "We'll probably eliminate it," says site manager Lorraine Greene. Things may get worse. Analysts say hackers are using "automated forum-spamming bots"—programs that hunt for online forums, automatically register, then send spam offering loot to other hackers. Think of it as direct mail for the cyber-crime economy.

–Brian Grow

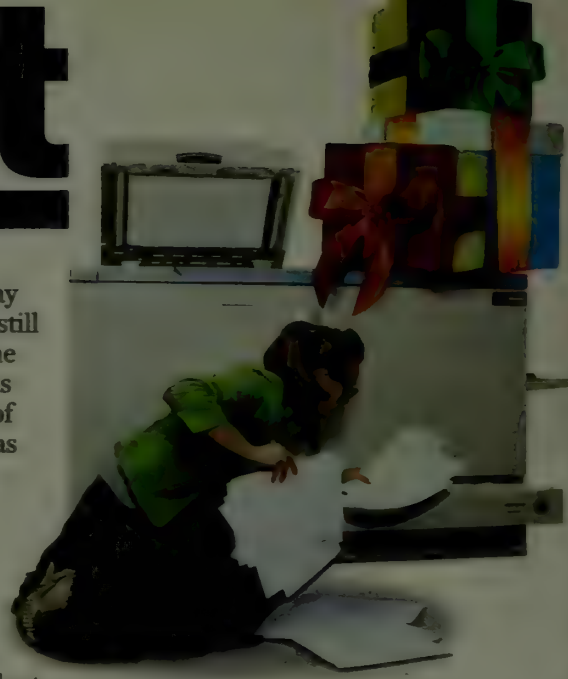
ENRON WATCH

SALVAGING CASH FROM THE WRECKAGE

PACKED INTO A complex of warehouses in Houston is the last best chance to extract value from the **Enron** name. The 3.3-acre site, once home to the company's broadband unit, is now filled floor to ceiling with crates of records that the Enron board is using to try to recover billions from bankers and other former advisers. Since emerging from bankruptcy in November, 2004, Enron has recovered $2.2 billion of cash and other consideration from **JPMorgan Chase** and four other banks. Suits are outstanding against five others.

It's just part of a massive effort to liquidate Enron's remaining assets and pay part of the $100 billion still claimed by creditors. The board hopes to have bids for **Prisma**, a collection of overseas gas pipelines, as soon as January. That's when a trial of former execs Ken Lay, Jeff Skilling, and Rick Causey is set to begin, which may complicate things. The liquidation created the legal equivalent of a toxic Superfund site.

Armies of attorneys file through the warehouses, seeking documents from more than 120,000 crates. Workers fetch color-coded boxes from towering shelves. Paralegals make sure the proper documents are inside. And clerks in a copy shop scan, print, and collate. Hardly the "asset-light" strategy Skilling envisioned—but perhaps it will prove more fruitful. *–Steve Rosenbush*



CORPORATE CULTURE

IF YOUR OFFICE photocopier is running out of ink, blame Gap. The clothing chain's new holiday "gift guide" includes this pointer on how to dress up a present: "Start with a colorful gift and stay late at work one day. Us the color copier to 'copy' the gift and then make your own wrapping paper from the prints." Then hide from your office manager. At 10¢ to 15¢ a page wrapping just a shirt box might cost 90¢. Gap spokesman Greg Rossiter says workers need to be aware of their employers' policies on personal copying. But he says the wrapping tip "recognizes that at this time of year customers' work and personal time is indistinguishable." Rossiter wouldn't comment on Gap's own internal copier policy. *–Louise Lee*

BLOGSPOTTING

ESTEEMING GREEN

TreeHugger.com

» **WHY READ IT:** If you're a fan of organic and environmentally sustainable products, this is the blog for you. It tracks the latest green trends and designs and is run by an international team of paid contributors.

» **NOTABLE POST:** A report, with pictures, on a "barkitecture" contest sponsored by the hip **Design Within Reach** furniture store chain: "The challenge [to architects] was to create a doghouse, with a volume not exceeding three cubic feet, that was under $1,000 and used at least some 'green' materials."

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UP Front

HEADLINER

HOWARD STERN

GET SET FOR WIDER EXPOSURE

For dirty talk and not-so-subtle sexual innuendo, Howard Stern is your man. But can Stern, 51, elevate two budding media technologies? We may soon find out. America will be exposed, as it were, to wall-to-wall Stern starting on Nov. 17 on *Letterman* and running through a Dec. 4 spot on *60 Minutes*. Stern will be promoting the Jan. 1 start of his gig with SIRIUS Satellite Radio, which will pay him $500 million over five years. And on Nov. 18 his older shows start selling via iN DEMAND's video-on-demand service. Sirius expects Stern to add 1 million new subscriptions, at $12.95 a month. And CEO Rob Jackson of iN DEMAND says operators are getting calls for Stern classics repackaged as *Girls, Girls, Girls* and *Get Naked*.

Things got truly wacky on Nov. 7 when Stern's employer, Infinity Radio, suspended him for a day because he blabbed too much about the switch. Yet two of the promos are set to run on CBS—which, like Infinity, is owned by Viacom. Stay tuned. *–Ronald Grover*

BANK NOTES

WHY BofA ISN'T HANDING OUT TOASTERS

IS BANK OF AMERICA intentionally trying to chase off depositors? That's what some analysts and rival bankers are speculating, given the bank's decision to let the rates it pays on certificates of deposit and money-market accounts suddenly fall way below those of other banks. In July, BofA's six-month Jumbo CDs were paying 2.75% in San Francisco—about a quarter-point below the local average. But by Nov. 1, they were paying just 1.49%—about half the 2.95% current city average, according to a survey conducted for *BusinessWeek* by **Bankrate.** Ditto in Houston, where BofA's rate on five-year CDs has fallen from the 3.49% it paid in July to 2.47% on Nov. 1—below the 3.87% average at other Houston banks. Bankrate found similar trends in Boston, Dallas, Los Angeles, Miami, San Diego, and Tampa.

The cuts may be BofA's way of complying with a congressional law that forbids banks to amass more than 10% of the nation's deposits through an acquisition, says Richard Bove, a banking analyst at **Punk Ziegel.** He notes that BofA's pending $35 billion deal for **MBNA** would put it ever so slightly over that 10% cap. Bove suspects BofA began cutting rates in hopes that enough depositors would defect in time for the regulatory review, which is under way. In fact, BofA's total deposits slipped from $640 billion to $633 billion between June and October.

BofA's CFO, Al de Molina told analysts in October that the bank chose to be less generous with CD rates as a way of "balancing market share and profitability." However, a BofA spokesman denies any effort to drive off customers. *–Dean Foust*

REWIND

CAN *MANGA* FERRET OUT YOUNG READERS?

Manga, the distinctive Japanese comic-book style, is sweeping the planet. Now it's being asked to rescue the moribund U.S. newspaper industry. Starting in January, a handful of papers, including ***The Los Angeles Times,*** will introduce *manga*-style comics to their Sunday funny pages. **Universal Press Syndicate** and **Tokyopop,** a U.S.-based entertainment company that publishes and develops Japanese comics in translation, will distribute two strips: *Van Von Hunter*, a warrior epic spoof, and *Peach Fuzz*, a playful chronicle of a 9-year-old girl and her pet ferret. Both are penned by Americans in English.

This summer, the success of *anime*- and *manga*-inspired products prompted a story in *BusinessWeek* to ask if Japan's animation products could be that nation's next big export (BW—June 27). The distinctive *manga* style—with wide-eyed characters and fantastic storylines—has inspired pop fashion as exemplified in artist Takashi Murakami's colorful, cartoony handbags for **Louis Vuitton.**

Newspaper publishers hope that *manga* can also draw in desperately needed younger readers; just 40% of 18-to-24-year-olds read a daily paper, according to the **Newspaper Association of America.** Still, the sight of a ferret where Snoopy once reigned may lead some old-time readers to exclaim: "Good grief!" *–Elizabeth Woyke*

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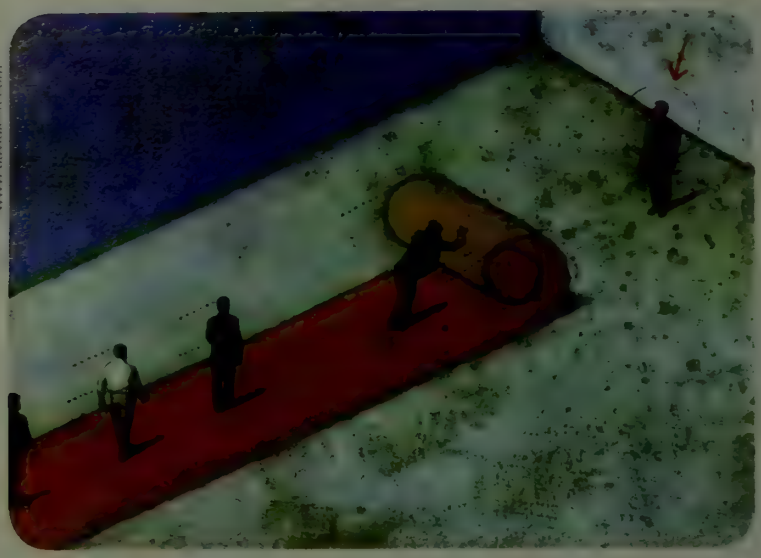

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Building a business around customers means mobilizing the entire company to that cause, but day-to-day execution generally comes down to solving one business challenge at a time. Indeed, when companies carefully examine how they are managing their customer relationships, they often discover that a few, deep-seated problems are undermining their efforts. Perhaps marketing is inundating high-value customers with irrelevant offers, or customer data collected by customer service representatives never makes its way into the customer knowledge base.

Such challenges—and many others like them—may be narrow in scope, but each problem solved becomes part of a larger chain of incremental success that lead to a much stronger enterprise-wide customer focus, greatly improved corporate performance, and accelerated growth.

Decisions Based on Facts

One company that is working to successfully put this principle into practice is Alaska Airlines, the Seattle, Washington-based passenger carrier.

Several years ago, the airline began adopting a series of aggressive, customer-focused initiatives designed to enhance the travel experience and build customer loyalty. Customer knowledge was central to these efforts.

"The planning, design, and execution of each initiative share a fundamental characteristic," explained James Archuleta, Alaska Airlines' CRM Director. "They are first and foremost driven by input from our employees and our customers." Fact gathering takes place one careful step at a time. It starts with frontline employees, like gate agents, reservations agents, flight attendants, and pilots, who have daily contact with Alaska's customers. These observations are then complemented by direct feedback obtained through a number of channels from the airline's more than 17 million customers including quantitative segmentation and product research.

From Insight to Action

More than that, in order to deliver the right service to the right customer at the right time consolidated information needs to be transformed into actionable insights. That means going beyond tracking high-level facts such as miles flown or dollars spent to assembling detailed portraits of customer groups. As with data collection itself, the airline is creating customer portraits one stroke at a time, through such steps as monitoring changes in the composition and character of the airline's customer base and constantly updating each group's behavioral profile and estimated lifetime value.

The airline will be using the resulting insights to deliver an optimal experience for each customer. For example, customers have indicated that they not only want to know if a flight was delayed, but also be given frequent updates on its status. The vision is to provide flight options available to them if the delay is significant.

This same philosophy is also being applied to the company's award-winning Web site, which one-third of the carrier's customers now use to book their flights. "By delivering personalized offers and information to customers over our Web site," Archuleta explained, "we will be able to strengthen our relationship with customers, increase satisfaction, and build loyalty."

Optimizing Every Interaction

The strategy is clearly paying off. Customers consistently rate Alaska highly for both overall satisfaction and the likelihood of repeat purchase, it's Mileage Plan has won three consecutive "best frequent flier program" honors at the annual Freddie Awards, and the airline was just voted best domestic airline in Conde Nast Traveler Magazine's 2005 Business Travel Awards.

The formula underlying this success is straightforward, Archuleta concluded: "Deliver great service and provide a memorable experience to each customer during every interaction, regardless of where, when, or with whom that interaction occurs."

To learn more about how leading companies are building their business around customers, please visit www.businessweek.com/go/customer and www.siebel.com/thecustomer.

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"Better utilization of health-care technology is one of the biggest opportunities in our global economy."

–Kris Johnson
-Granite Bay, Calif.

TORT REFORM MAY BE MOVING AHEAD, BUT IT HAS A WAYS TO GO

ALTHOUGH U.S. District Court Judge Janis Graham Jack's ruling finally brings the beginning of fairness and sense to tort reform, it does nothing to punish a system that has been out of control for years ("A break for the defense," Legal Affairs, Nov. 7). Courts at both the state and federal level need to not only revisit the hundreds of phony injury claims but mandate a cash bond be placed in escrow by plaintiff firms for past cases that may be in question. This, as well as criminal prosecution of these plaintiff firms if found in breach of ethical standards, could finally bring some sanity to the courts.

–Kevin C. Kenney
Dallas

IMPROVEMENTS IN MEDICAL DATA ARE JUST THE BEGINNING

"THIS MAN WANTS to heal health care" (Special Report, Oct. 31), on David Brailer's work to establish a National Health Information Network, was excellent in providing details on the many aspects of medicine that this network would touch. The negative aspects mentioned in the article—reduction of care options, privacy concerns, practitioner backlash, and patients paying more of their medical bills—sound scarier than what the reality can be. All of the concerns voiced in this article can be addressed and resolved.

Better utilization of health-care technology is one of the biggest opportunities in our global economy. The reduction of costs through this type of quality improvement process allows for more investment capital in new technologies as well as the reduction of cost to the end users, paving the way for more participants in health-care programs.

–Kris Johnson
Granite Bay, Calif.

DAVID BRAILER'S PLAN really would save lives and billions of dollars. He left out one important factor, however: Centralizing of patients' files could bring an additional 10% reduction in the cost of health care.

Now a well person at age 83, I have one primary-care physician—and from time to time I visit 10 other specialists, laboratories, urgent-care facilities, and hospital offices. At each office I am asked for a detailed history of my health—at some, a second time as they update computer files. In addition, every office has a room full of

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ReadersReport

CORRECTIONS & CLARIFICATIONS

n "Shoot the focus group" (Marketing, Nov. 14), Invoke Solutions' headquarters is in Wellesley, Mass., not Stamford, Conn. And the correct spelling of its chief operating officer's name is David Rubinstein.

"Controversy of the week" (The Business Week, Nov. 21) incorrectly stated that "schools have canceled American Girl fashion shows." We can confirm only one school that canceled such an event.

anila folders filled with patient information. The cost of my time is not included in e health-care equation, but certainly the st of each support person is.

–Ray O. Sims
Roseburg, Ore.

UDOS TO *BUSINESSWEEK* OR GIVING PARKS HER DUE

HANK YOU FOR giving Rosa Parks the cognition she deserves ("What business ves Rosa Parks," Editorials, Nov. 7). I'm hite and now retired, but to see her ourage was and is impressive.

–Mary L. Mongeon
Newmarket, N.H.

ALIFANO: WHAT DOES MARLBORO AVE TO CELEBRATE?

NSTEAD OF holding a celebration for Marlboro's 50th birthday, Philip Morris hould be holding a memorial service "Leader of the packs," Marketing, Oct. 1). According to the Centers for Disease ontrol & Prevention, smoking kills 40,000 people in the U.S. each year. Marlboro's market share of 40% means hat this brand of cigarettes alone is responsible for the deaths of 176,000 people nnually. I am disappointed that *Business-Veek* chose not to include this information. dditional restrictions on tobacco advertising and marketing are sorely needed.

–Joseph A. Califano Jr.
Chairman and President
National Center on Addiction & Substance Abuse
New York

ditor's note: The writer is former Secretary of Health, Education & Welfare.

ARNIA'S CHRISTIAN THEME ILL BE A WINNER FOR DISNEY

N "THE LION, the witch, and the franhise" (Entertainment, Nov. 7), Ronald rover frets that the movie "comes with a eady-made marketing tinderbox: The seies is a lightly disguised Christian alleory about four children who find a magical wardrobe and are transported to an eternal world" where "the Christ-like lion Aslan dies to protect a child but then is resurrected." Peter Sealey, a marketing professor at the University of California at Berkeley, says that if Walt Disney Co. "markets it too heavily as a Christian film, others may take a walk."

That's why Sealey is a professor, and Disney is Disney. Don't I recall a Mel Gibson who "risked" his own money on something called *The Passion of the Christ*? The only way this movie will flop is if it fails to adhere to its author C.S. Lewis' "passionate" pen. This one is in the bank.

–Jeff Parrack
Fort Worth

DON'T DISCOUNT DELL IN CHINA

DELL IS STRONG, growing, and profitable in China ("Dell may have to reboot in China," News: Analysis & Commentary, Nov. 7). In the quarter just ended, our product shipments increased more than 45% year over years. Our volumes of mobile notebook computers doubled. Overall, Dell China revenue jumped nearly 30%. While Dell already ranks No. 3 in total share—and No. 2 in servers—there remains tremendous opportunity for us in China. Dell's consumer revenue in the country more than tripled last quarter. Our emphasis, however, is on direct sales to corporate, government, and education customers, who together account for two-thirds of all demand in China, and in the 36 largest cities to which 70% of industry shipments are made.

–Lynn A. Tyson, Vice-President
Corporate Communications and Investor Relations
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Round Rock, Tex.

How to reach *BusinessWeek*

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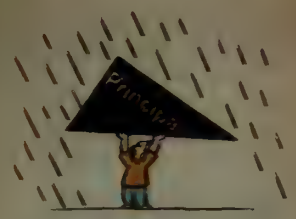

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Green Foot Forward

FOR JOHN R. HOKE III, Nike Inc.'s chief design guru, flashes of inspiration can strike at the Detroit Auto Show, the furniture festival in Milan, or while gazing at a porcelain saucer by 99-year-old potter Eva Zeisel. Nike footwear reflects this whole range of influences, but now Hoke wants his designers to think of Mother Nature.

The new ethos at the Beaverton (Ore.) sneaker giant is known as sustainable design. Following a corporate-wide mission called "Considered," Hoke, 41, urges his designers to create products that deliver more based on less—less energy, less chemical content, less waste. He also tells the team to forget about glues, adhesives, plastics, and other toxic materials used in traditional sneakers. "I'm very passionate about this idea," he says. "We are going to challenge ourselves to think a little bit differently about the way we create products."

Pushing the design envelope is nothing new for Nike' team. These are the people who created such radically new cushioning systems as Nike Air and Nike Shox. They also redrew the running landscape with minimalist, nearly barefoot running sneakers, called Nike Free.

The premise for Considered begins with the deconstruction of a traditional sneaker. Hoke wants designers to rely on geometry, not chemistry, to figure how to rebuild a shoe. Shunning adhesives, designers are coming up with snap-fit systems that may be reinforced with organic cotton stitching. These fibers hold together mid- and top soles composed of natural leather instead of synthetics. In a basketball shoe, designers are replacing a plastic heel cup with one made out of natural materials. Instead of a foam lining pack, "we're looking at fillers of bamboo fiber, which are renewable" he says. "We're taking out what is not necessary."

So how does Hoke set the conditions for lightning to strike? Design inspiration trips, for one. He sends his team to the zoo to observe and sketch animals' feet. He'll hold a lecture on the glass sculptures of Dale Chihuly or bring in Eva Zeisel to discuss structure and forms. The Detroit car show is another annual pilgrimage that is more about drawing inspiration from sleek lines, styling, and color schemes than the fascination with automobiles. "I go to the show, and I'm not even looking at cars," Hoke says. "I'm looking at form, surfacing, and silhouette. I'm looking at the assembly of materials, the depth of color."

Nike's Hoke is prodding his designers back to nature and away from plastics

One design camp involved an excursion int origami with its rigorous focus on constraints. Designers were asked to build an ergonomic chair out of cardboard. Instead of conventiona glues, participants had to concentrate on folding and bending. Then Hoke threw in another twist: The judging would be based on whether the new seats could hold people in a contest of musical chairs. Hoke also brought i an Israeli origami artist as a tutor, and "we ha designers fold paper for three days," he says. "The ideas that have come from that session a phenomenal. It forced us to look deeper at flexibility and how geometry works." Instead of cutting and sewing, he says, "what about crimping, folding, and bending"

Hoke first started sketching Nike sneakers as a teenage runner. In 1979, at age 15, he submitted a sketch to Nike founder Phil Knight—a way to hold air in the middle of the sole. After earning bachelors and masters degrees in architecture, Hoke joined Nike in 1993 and was put in charg of creating Niketown stores. Seven years later, he was responsible for designing Shox XTR, a training shoe with the Shox cushioning system. Hoke now sits on the board of Herman Miller Inc. and makes design a 24/7 lifestyle. No wonder the designer sees the world differently. ■

–By Stanley Holm

BusinessWeek online For a Q&A with Hoke on innovation and Nike's Considered initiative go to www.businessweek.com/extras

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Technology&You

BY STEPHEN H. WILDSTROM

Boomer-Friendly Gadgets

For decades now, the U.S. marketing mainstream has been defined by the various stages baby boomers pass through on their journey through life. With the oldest of them about to hit 60, it's no surprise that sellers of hardware and software are focusing on "assistive technologies" to aid users with poor vision or motor-control problems. Some of the first innovations in this area were intended to make tiny print appear larger. Microsoft Windows and Apple Mac OS have included screen magnifiers, though not very good ones, for several years. But the latest development, Microsoft's Comfort Optical Mouse 3000 (about $27), makes magnification both useful and convenient.

Clicking a small button on the left side of the mouse opens a window on your display—wherever you place the cursor—that serves as a magnifying glass. If you hold the button down and move the mouse to the left, the window grows horizontally. Move right, and it shrinks. Pushing the mouse up makes the window taller, and pulling it down makes it small. Turning the scroll wheel while pushing the button controls the degree of magnification. Sometime next fall, Microsoft will release its Vista version of Windows, which will allow much greater magnification because it will let type grow indefinitely without breaking it up into pixels, as it does in Windows currently. (Right now the same software for Mac is far less versatile: The magnification window is always the whole screen.)

OPTICAL MOUSE 3000 Press here, and your cursor becomes a magnifying glass

MICROSOFT DOESN'T PROMOTE the magnifier as an assistive technology, just a convenience feature. In a sense, the company is right. All of us, no matter how strong our eyesight, have run into trouble with e-mails or Web pages where the type is too small to be read comfortably. As boomers move into their 60s, they are going to find this sort of help more and more useful.

Visual acuity is only one of the things we stand to lose in middle age. Muscles can also turn into traitors, especially during epic sessions in front of a PC. The shaking that plagues people with Parkinson's, essential tremor, and other ailments can make it very difficult to manipulate a mouse—and the challenges are amplified by the latest generation of supersensitive mice, which respond to much smaller motions.

Drawing on technology developed by IBM Research, a small British company called Montrose Secam developed the $119 Assistive Mouse Adapter, a small box you plug in between your mouse and your computer. Using the same kind of electronics that stabilize images in cameras and binoculars, it essentially insulates the mouse from the erratic motions caused by hand tremors. A dial allows you to control the delicate balance between smoothing and sensitivity for the best results. I don't have a tremor, but when I simulated one, the adapter proved remarkably effective.

Speech-to-text and text-to-speech technologies, which have found only limited acceptance outside the world of assistive technologies, may also start to extend their reach. Speech software from IBM called ViaScribe generates captions on the fly for online versions of lectures at a consortium of schoo led by St. Mary's University in Halifax, N.S., and including Massachusetts Institute of Technology and Purdue. Frances West, director of the Accessibility Center at the T.J. Watson Researc Center in Hawthorne, N.Y., says that while it was designed for students with hearing difficulties, it also benefited non-native English speakers. Ultimately, even students with no disabilitie felt it improved their understanding.

Technology developed for those with special needs goes mainstream

Clearly, technologies that were originally designed for a relatively small number of people with special needs will be moving into the mainstream. If recent marketing trends are any indicator, more and more of the innovation will be aimec at users on the far side of 50. ■

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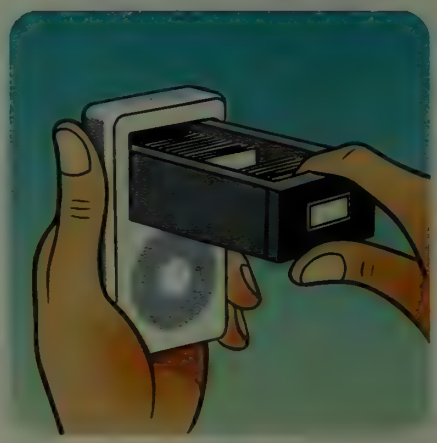
Can Podcasting Do Business?

Media today. They grow up so fast. ¶ Latest evidence: The beta test of Podzinger.com, which performs keyword searches through transcribed audio feeds for thousands of podcasts. Podzinger, which is expected to launch in December, ultimately seeks to be a Google of multimedia search—and sell Google-style text ads alongside search results—but is honing its service first with podcasts. These, a Podzinger executive argues, need some sort of organizing principle. "Without relevant search results, it's a world before Google," says Alex Laats, a divisional president at Podzinger's Boston-based parent BBN Technologies.



Podzinger is a relative latecomer. (Assuming, that is, you can append "latecomer" to a medium so new its name is less than two years old.) Already in the space: Blinkx.com, Yahoo!, and AOL. And on Nov. 11, Audible Inc. unveiled a measurement tool for podcast listenership.

Some of these tools seem very Version 1.0, but more on that later. They all show a semi-medium rapidly reaching early adolescence. An infrastructure to enable commerce—search, networks, measurement—is sprouting. There are two reasons for this. One is the ubiquity of the iPod (almost 30 million units sold). The other is the speed these days with which players glom onto anything that glimmers, even faintly, like the Next Big Media Thing.

Still, some basic conceptual questions about the medium remain unsettled. Podcasting is, obviously, downloaded audio. But it's not clear if listeners will ultimately regard podcasts the way they do downloaded songs, in which case an ad is unwelcome, or as a form of radio, in which case it's acceptable. This being the 21st century, it's hard to imagine that podcast advertising will be universally rejected. But some ad executives still express caution. "We are trying to test what the tolerance [for advertising] is going to be," says Eric Blankfein, a senior vice-president at New York-based media buyer Horizon Media. Podcasting "is something quote-unquote pure. How do you mess it up with branding?"

We're finding out. On Nov. 14, Georgia-Pacific announced its Dixie brand's first podcast sponsorship, on parent-themed *The MommyCast*. "Somewhere amidst all of this we will reinvent audio advertising," says Adam Curry, a former MTV VJ and president of programming for the PodShow Podcast Network, which brokered the deal and counts *The MommyCast* as a member.

Curry posits that the business model for podcasts may resemble blog networks such as Weblogs Inc. So it may come as a surprise that he sees little "value for search in podcasting." It's true that Podzinger theoretically endangers PodShow's hopes to be the portal and front door to the medium. But Curry's views are shared by others in the podcast universe.

There are limits to the blog analogy: Blogs may struggle with invisibility, especially among advertisers, without blog-search engines like IceRocket. You don't need Google to navigate the radio dial. With podcasting, you may need recommendations, such as Amazon.com's, or promotional snippets, or podcasts organized by genre. It's less useful to know which podcasts use the terms "Volvo" or "AC/DC" the most.

Search tools, ads, listener analysis—the medium may be growing up too fast

Still, search engine moves are being met with chocolates and flowers compared with Audible's effort to measure podcast audiences. Audible plans to charge podcasters 3¢ per download to analyze usage. Podcast enthusiasts point out that this amounts to impossible sums for podcasts that count downloads by the hundred thousand—and revenues by the nickel. "The marketplace is telling [Audible] they're on the wrong road," wrote Jeff Jarvis on his blog BuzzMachine.com, echoing many critics.

Podcasting is the teenage clique of media. Small enough that its pioneers refer to one another by first names only, young enough that it's unclear which media model fits it, and brazen enough to believe it can figure it all out by itself. Parents will tell you how stubborn adolescents can be—and how, more annoyingly, adolescents are sometimes right. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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The Barker Portfolio

BY ROBERT BARKER

Chipotle's Jalapeño of an IPO

Tonaysha Askew and Summer Trazzera were torn: Wait, or go elsewhere? At 11:48 a.m. the other day, they stood in a line that already had extended 10-deep outside a Chipotle Mexican Grill in Orlando. "She's obsessed with this place," Trazzera told me. "Yeah, I'm obsessed," Askew said. So they waited, 18 precious lunch-hour minutes, to get takeout. What makes Chipotle worth a wait? "It's fresh. It's filling," Askew said. "And," Trazzera put in, "they don't sacrifice the quality."

Choosing Chipotle, the young women passed over such former haunts as Taco Bell and Subway, never mind a nearby McDonald's. This is no cause for alarm at Mickey D's, however, since it owns 92% of Chipotle and aims soon to sell stock in an initial public offering (table). The deal's key terms—number of shares, price—have yet to be set by Chipotle and its lead underwriters, Morgan Stanley and SG Cowen. Yet when they do fix a price, don't look for a bargain. This IPO figures to be hotter than a jalapeño.

BASED IN DENVER, CHIPOTLE opened its first restaurant there in 1993. Founder and Chief Executive Steve Ells, who now is 40, got his degree in art history at the University of Colorado and then went on to the Culinary Institute of America before apprenticing at a fancy San Francisco restaurant. Two years later, he set out to bring what he knew about fine food to a mass market. Chipotle makes to order a small variety of Mexican dishes—tacos, salads, and its signature burrito, served with or without the tortilla wrapping. It's tasty: I had a burrito plus an especially delicious side order of guacamole and fresh tortilla chips. With an iced tea, the tab came to $9.96. McDonald's was sold on the idea and in 1998 bought control.

To investors, Chipotle's record of growth has to look mouth-watering. The chain expects by yearend to have more than 480 stores, 312 of them added since 2002. From revenues that year of $205 million and a pretax loss of $17 million, the past four quarters brought revenue of $542 million and a pretax profit of $14 million. The balance sheet i lean—at June 30, net debt came only to $11 million, most of that on a line of credit from McDonald's—and shareholders' equity stood at $292 million.

Chipotle Mexican Grill	
Revenues	$542 million*
Pretax Income	$14 million*
EBITDA**	$41 million*
Net Debt	$11 million*
Number of Restaurants***	454
Tentative Symbol	CMG
How You Say It	chi-POAT-lay
Calories in an Order of Guacamole and Chips	660

*Financial figures are for the 12 months ended June
**Earnings before interest, taxes, depreciation, and amortization
***As of Aug. 31. 30 more planned by yearend

Data: Company reports, Capital IQ

HAPPY DEAL McDonald's bought control of Chipotle in 1998

Risks? The biggest is the hunger for capital that Chipotle's growth strategy implies. In the past four quarters, the company ate the $56 million that operations generated plus $30 million more as it opened locations. Proceeds from the IPO will feed some growth, but investors have to wonder when Chipotle will need to raise fresh capital either by borrowing or selling more equity. Another worry is the shares that McDonald's figures to sell or hand out to its own stockholders in the future. Chipotle's registration statement notes that the company expects McDonald's ownership stake eventually will "decline significantly." Then, Chipotle may feel pressure on its margins. Via McDonald's, it pays less for everything from workers' compensation insurance to beverages from Coca-Cola to credit-card processing. These costs and more are set to rise as McDonald's stake falls. Finally, there's the annoying fact that McDonald's is ensuring its hold on Chipotle via a class of supervoting stock.

Just the same, shares in Chipotle are a cinch to attract high interest. How might investors value them? One guidepost is the last hot stock in the "fast-casual" end of the restaurant biz, Panera Bread. At the height of investors' love affair with this bakery cafe, in the spring of 2002, the stock went for 4.6 times trailing revenues. At that, Chipotle would command a market value of nearly $2.5 billion, or 88 times earnings. Don't be surprised if investors wind up as obsessed with the stock as Tonaysha Askew is with the burritos. ■

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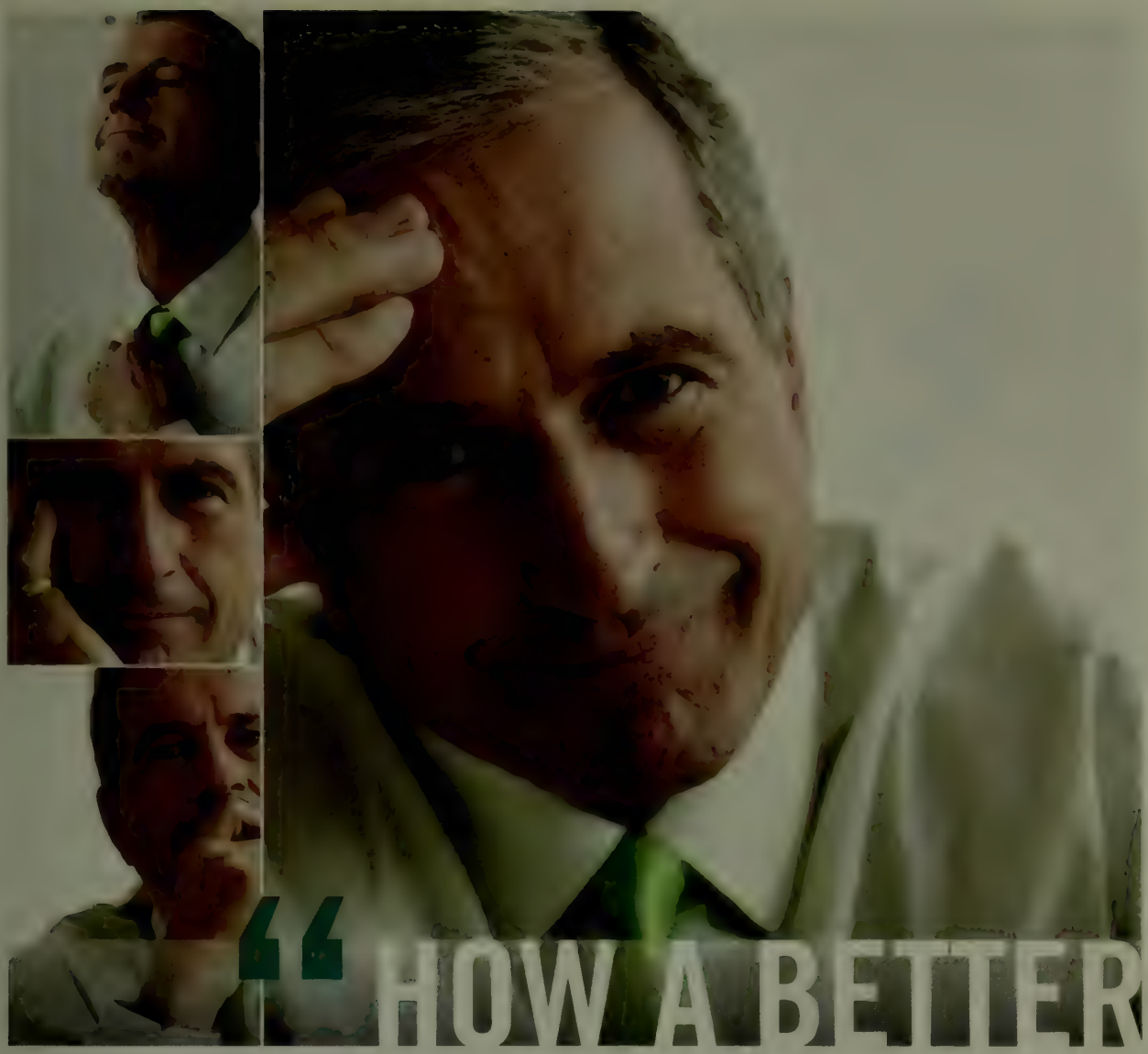

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NATIONAL PUBLIC LANDS DAY

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IT'S NOT A CHART, A GRAPH OR A REPORT.

IT'S WALKING INTO THE SEA OF CORTÉS AT SUNRISE.

KAYAKING WHILE A WHALE BREACHES IN FRONT OF YOU.

IT'S THE SUN DIPPING BEHIND A MOUNTAIN RANGE, AGAIN AND AGAIN.

IT'S A PLACE WE LIVE IN, A PLACE WE HAND DOWN TO OUR CHILDREN,

AND THEIR CHILDREN.

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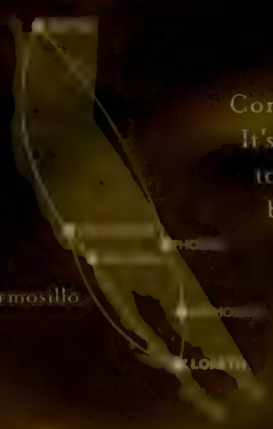

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Y JAMES C. COOPER & KATHLEEN MADIGAN

The Real Inflation Threat Isn't Energy

Pressures are building because companies are struggling to meet demand

U.S. ECONOMY Will lower energy prices add to inflationary pressures? If that sounds a bit counterintuitive for you, consider this: The economy is already growing so rapidly that it is putting pressure on available labor, production capacity, and distribution channels. Recent price declines, including the drop in gasoline prices, mean that the headline inflation numbers will look better in coming months. But cheaper energy bills free up cash that can be spent on other items. A pickup in demand, especially by consumers, will only add to the tight market conditions that tend to foster broadly higher prices.

For now, costlier energy and the potential pass-through of higher fuel bills to other prices remain a key focus of inflation worries. However, energy prices would be much less of a concern for inflation in general if the economy were not so fundamentally robust. Indeed, the biggest danger in the inflation outlook for 2006 is not necessarily the direction of oil prices. It's the economy's persistent tendency to exceed its speed limit.

Even with the past spikes in energy prices as well as the summer's hurricanes, demand continues to grow so fast that the available productive resources can barely keep up. For the past 2½ years, the economy has expanded at an annual rate of 4%, with growth in any one quarter never less than 3.3%. That trend far exceeds the economy's growth limit, generally accepted to be about 3¼%. Whatever slack was created by the recession in 2001, it's now either nearly or completely gone.

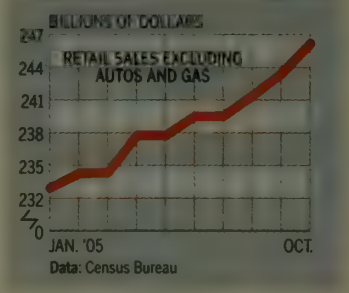
It is the broad upward pressures on inflation that will be the primary focus of the Federal Reserve and its presumptive new chairman, Ben S. Bernanke, who won near-unanimous support in a Nov. 16 vote of the Senate Banking Committee after his confirmation hearings the day before. Identifying the intensity of those forces and communicating the Fed's policy goals to the markets will be the next chairman's most critical tasks in the coming year (box, page 32).

SO FAR THE PRICE INDEXES show few signs that prices outside of energy are heating up. Consumer prices in October rose 0.2% from September, as did the core index, which excludes energy and food. At the wholesale level, energy pushed producer prices up 0.7% in October, while the core index fell 0.3%, although that fall resulted from a quirky drop in car prices, a reflection more of government statistical methods than sticker prices. Nevertheless, the continued buildup in demand suggests core inflation is more likely to rise than slow in coming months.

How resilient is demand? Just consider how little an impact Hurricane Katrina and the related spike in energy prices had on consumer spending (chart). If anything, the more dramatic shift in demand has come from the boom-bust pattern associated with the timing of the auto industry's "employee discount pricing" plans.

According to the Commerce Dept., October retail sales slipped 0.1% from September. But excluding the slump in the month's car buying after the pricing program ended, retail receipts jumped a strong 0.9%. That gain would have been higher but for the dip in gasoline prices, which dragged down receipts at gas stations. Commerce also said retail buying in both August and September were a bit higher than its earlier estimates.

HURRICANES OR NOT, CONSUMERS KEEP BUYING



Data: Census Bureau

Further gains may be on the way, thanks to cheaper energy. Average gas prices are down 25% from their post-Katrina high, to $2.30 per gallon on Nov. 14. And based on the current trend in wholesale prices, pump prices could approach $2 by yearend. Using Commerce data, a 25% drop in gas prices over three months adds some $80 billion, at an annual rate, to household purchasing power, which can go to other things. Any further declines in gas prices mean even more money to spend.

Little wonder then that some retailers are expressing a bit more confidence about yearend shopping. For example, Wal-Mart Stores Inc. expects its November same-store sales to be 3% to 5% higher than sales a year earlier. And company officials expressed optimism about holiday and post-holiday revenues, citing the recent declines in gas prices.

OF COURSE, STRONG SPENDING by itself doesn't automatically generate pressure on prices. Increasing constraints on the supply chain are the key link between current economic growth and the inflation outlook. And as any student of Econ 101 knows, too much demand

chasing not enough supply can trigger higher prices.

The Fed's latest revisions to industrial production and capacity show companies are using more available capacity than previously thought. The operating rate in manufacturing averaged 78.2% in the third quarter, a half-percentage point above what last month's data showed, and factory activity remains strong.

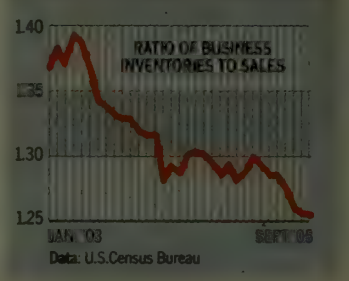
The tightness on the production side is also evident in how long it takes for supplies and merchandise to reach businesses. According to the Institute for Supply Management, delivery times in October were the longest in more than a year. And the jump in delivery times over the past two months was the biggest in 26 years.

No wonder businesses have had to use their inventories to meet growing demand. Real business stockpiles fell in both the second and third quarters, the first back-to-back declines since the economy came out of the 2001 recession. Some of last quarter's liquidation was in autos, and car companies are already boosting their production this quarter to meet the demand generated by a new round of sales incentives. Overall, September inventories held by manufacturers, wholesalers, and retailers rose 0.5%, even as sales rose faster. After stabilizing in 2004 and early 2005, the ratio of inventories to sales is falling again (chart).

IF CONTINUED, these supply trends are warning signals about inflation. Production bottlenecks, delivery delays, and a short supply of goods on hand create a situation where businesses have an easier time raising their prices.

And it's not just merchandise that is in short supply. Companies also report greater difficulty in finding workers with certain skills. The jobless rate slipped back to 5% last month, and tighter labor markets may be beginning to push up pay. The average hourly wage for production workers grew at an annual rate of 3.4% in the six months through October, the fastest such pace in 2½ years.

INVENTORY LEVELS LAG BEHIND SALES



Data: U.S.Census Bureau

One critical question is whether productivity gains will offset the pickup in pay. So far, greater efficiency is still restraining the rise in unit labor costs. But productivity is slowing, threatening to loosen those reins. Higher labor costs will give companies another reason to try raising prices to protect their bottom lines. That strategy may already be in play if the surprisingly strong performance of third-quarter profits is any guide.

Unless the economy slows in the first half of 2006 to a pace that will relieve some of the stress on businesses' ability to meet demand, then inflation pressures will keep building even if energy prices continue to fall. More important, cheaper energy, by itself, will not be the key to the Fed's decisions on interest rates next year. ■

MONETARY POLICY

BernankeSpeak: A Plus for Investors

WILL GREATER OPENNESS be a hallmark of a Bernanke Federal Reserve, much like it was under outgoing Chairman Alan Greenspan? Looks that way, given Ben S. Bernanke's testimony during his confirmation hearings to become the next Fed chairman. And his reassurance isn't just good news for Fed watchers who like to parse every phrase in each policy statement. It also means investors can worry less about their portfolios after the regime change.

Bear in mind that financial markets hate uncertainty. And a Fed discussion paper released in October found that unexpected moves by the central bank can trigger particularly large moves in the prices of stocks around the world.

Fed economist Jon Wongswan looked at 16 stock indexes from Argentina to the U.S. during the period of September, 1998, through November, 2004 (excluding the emergency Sept. 17, 2001, meeting after the terrorist attacks). A surprise 25 basis-point cut in the federal funds rate caused stocks to rise, on average, as little as 0.5% in Malaysia to as much as 2.5% in Korea and Hong Kong. U.S. equities tended to climb about 1.8%, and the German bourse by 1%. Drops of similar magnitudes show up when the unexpected move is a rate hike.

HOW FED ACTIONS CAN JOLT STOCK PRICES

PERCENT CHANGE IN STOCK PRICES FROM AN UNEXPECTED QUARTER-POINT CUT IN THE FEDERAL FUNDS RATE

BRAZIL	1.79%
BRITAIN	1.11
GERMANY	0.99
JAPAN	0.82
KOREA	2.45
U.S.	1.79

Data: Federal Reserve

Interestingly, Bernanke himself has studied the effect of surprise Fed moves. He wrote a 2003 paper on the subject with Fed economist Kenneth N. Kuttner. But that paper had a different time frame, so it showed only a 1% reaction in U.S. stocks, less than Wongswan found.

One key area of openness where a Bernanke Fed may differ from the Greenspan era is in the nominee's support for inflation targeting (page 138). In his Nov. 15 testimony before the Senate, Bernanke said that a set target range for inflation could have several advantages, "including further reducing public uncertainty about monetary policy and anchoring long-term inflation expectations even more effectively." To the extent that an explicit inflation goal removes the risk of future surprise Fed moves, Bernanke could promote the desire for reduced stock market volatility around the world as another benefit of inflation targeting. ■

–By James Mehring in New York

GAME ON.

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Which Retailers Will Santa Visit? A tale of two discounters could say a lot about the Christmas outlook. On Nov. 14 investor darling **Target** deflated Wall Street's holiday spirits when it said it would probably miss its November forecast of a 4%-to-6% sales increase at stores open at least a year. Meanwhile, **Wal-Mart** (a Philadelphia store, right) said it was on track to meet its forecast of a 3%-to-5% gain and expected a dandy Christmas. November will mark the first time in a year and half that trendy Target hasn't trounced its downscale rival.

To Marshal Cohen, chief analyst at researcher NPD Group, the role reversal spotlights a key trend. Crunched by energy costs, credit-card debt, and the psychological impact of softening home prices, consumers will be more inclined to trade down this season. Emporiums that could feel the pain include Target, **Abercrombie & Fitch, Coach, Tiffany,** and **Nordstrom.** Much-maligned Wal-Mart, Cohen argues, "will be in the sweet spot."

Koch Nails Georgia-Pacific **Charles Koch** is a CEO who likes to run his family business the old-fashioned way—secretively. That may be a little harder from now on. **Koch Industries**, which Koch took over from his father and company founder, Fred, 38 years ago, agreed on Nov. 14 to fork over $21 billion in cash and assumed debt for paper giant Georgia-Pacific. The deal vaults the Wichita conglomerate past **Cargill** to become the biggest privately held outfit in the U.S., with sales of roughly $80 billion. But taking on the debt will put Koch more under the microscope of lenders and ratings houses. The deal offers yet another example of the pleasures of going private these days.

See "This Spree Could Spur a Stock Surge," page 44, and "Koch: Very private and a lot bigger," businessweek.com/go/tbw

The Incredible Rising Dollar Remember all those predictions last winter that the greenback was certain to be crushed in 2005 under massive U.S. trade deficits? Oops! The dollar has levitated about 15% against both the euro and the yen this year, though the fearsome deficits turned out even bigger than expected. On Nov. 16 the dollar reached a 27-month high against the yen and a 24-month high against the euro. Dollar bear **Warren Buffett** said on Nov. 4 that his firm, **Berkshire Hathaway,** had lost about $900 million through September on currency bets. Behind the dollar's allure: Investors love the higher inflation-adjusted yields on U.S. securities. "Real" rates on 10-year government bonds are around 2% in the U.S., vs. 1.5% in Europe and 1% in Japan.

Everyone Into the Video Pool New entrants are crowding the video-on-demand swimfest. Diving in on Nov. 14 was **Time Warner's AOL** unit, which will offer such oldies as *Welcome Back, Kotter* and *Chico and the Man.* And **Viacom** says **Nickelodeon** will sell *SpongeBob SquarePants* and other kiddie fare for $2.99 on **Hasbro's** iPod-like VuGo portable player. Lots of splashing, but no clear lane to profits: AOL will show ads, as will **CBS,** which last week said it would offer some hot shows like *Survivor* for 99¢ on **Comcast** cable systems. **Apple** is charging $1.99 for iPod users to see ad-free **ABC** shows such as *Desperate Housewives.* Industry sources say **Fox** will soon offer its own Internet site, with shows like *24* and *The Simpsons,* but no word on prices as yet. Why all the different strokes? Because no one has a clue how many users will sign up.

See "Behind those video-on-demand deals," www.businessweek.com/go/tbw

Starwood's Hotels Find Lodging This room just keeps getting tidier. On Nov. 14, Starwood Hotels & Resorts, the parent of such names as **Sheraton, Westin,** and **W,** struck a deal to offload 38 properties to real estate giant **Host Marriott** for $4.1 billion in stock and cash. Starwood will still manage the hotels for as long as 40 years. Besides cutting Starwood's net debt from $3.1 billion to $1.5 billion, which may bring a ratings upgrade, the agreement speeds its transformation into what CEO Steve Heyer likes to call a "consumer lifestyle company." Translation: more managing for reliable fees, less playing in the volatile property market. As for the buyer, the inns round out its portfolio nicely, and the new brands will lead it to drop the Marriott name and become **Host Hotels & Resorts.**

Knight Ridder Knuckles Under When your largest shareholder and two other biggies tell you the jig is up, it behooves you to pay attention. On Nov. 14, Knight Ridder, the San Jose (Calif.) publisher of 32 newspapers, did just that, asking **Goldman Sachs** to explore "strategic alternatives"—read, look for a buyer. That's what **Bruce Sherman,** head of Naples (Fla.) investment house **Private Capital Management,** had demanded on Nov. 1. Sherman's firm owns 19% of the stock and was displeased with its performance. Now the question is who'll want this grab

ıg of large-to-small-market dailies when readership is eclining and ads are migrating to the Web. Knight idder could well be carved up among rival publishers ıd private equity outfits.

ee "Where Ridder went wrong" (BW—Nov. 21), and "Knight Ridder makes it official," www.businessweek.com/go/tbw

uidant and J&J: Happy Together In the end, they uried the scalpel. On Nov. 15, **Johnson & Johnson** and uidant agreed that J&J would pay $21.5 billion for the ıdianapolis medical-device maker, down $4 billion om the deal struck last December. J&J had balked after uidant was forced to recall pacemakers and defibrillaors. Guidant, in turn, sued J&J to fulfill the original deal. makes sense that the two decided they'd rather heal han fight: Guidant faces lawsuits over the recalls, which ave maimed its market share, while J&J needs to exand its device business now that its pharma unit is howing stunted growth. Grafting on Guidant may be ricky for J&J, since it's unlikely to let its ailing partner un autonomously.

See "J&J and Guidant: Buyer beware," www.businessweek.com/go/tbw

Medicare's Drug Muddle Too bad there's no pill to ure confusion. Nov. 15 was the day seniors could start igning up for a new prescription drug benefit—perhaps **President George W. Bush's** signal domestic accomplishment.

Alas, the program seems calculated to induce dizziness, and most seniors have no idea which plan suits them best. Faced with dozens of choices—in some states, more than 40—many may freeze and do nothing. Medicare is scrambling o help the elderly and their families find their way. They ave until May.

See "A compass for the Medicare maze," page 128, and "Medicare makes its move," www.businessweek.com/go/tbw

Daimler Unloads Mitsubishi He came, he saw, he ought. Now, **Jürgen Schrempp's** company is selling—and ditching his vision of a globe-spanning empire. On Nov. 11, **DaimlerChrysler** dumped at a discount its remaining 12.4% stake in banged-up **Mitsubishi Motors** to Goldman Sachs, which flipped the shares the same day to institutional investors. Schrempp, who will step down as CEO on Dec. 31 and has virtually vanished from the field, trumpeted the investment in Mitsubishi in 2000 as the vital Asian bulwark of his "World Inc." (Welt AG). Instead his moves wrecked profits and stretched management so thin that once-No. 1 **Mercedes** fell behind **BMW** in the global market for luxury cars. CEO-designate **Dieter Zetsche** will probably focus on jettisoning nonworking parts and turning Daimler back into a mean machine.

See "Auf Wiedersehen, Mitsubishi" and "Goldman's fast Mitsubishi move," www.businessweek.com/go/tbw

In the Tax Trenches Most lawmakers on Capitol Hill want to cut taxes, but as ever, they disagree about whose. On Nov. 15, the **Senate Finance Committee** voted to provide millions of families another year's relief from the dreaded alternative minimum tax but refused to extend the 15% tax rate on capital gains and dividends, which is due to rise at the end of 2008. At the same time, the **House Ways & Means Committee** voted to keep low capital gains rates for another two years—through 2010—but refused to fix the AMT. Oh, and the Finance Committee whacked more than $1 billion a year in tax breaks now enjoyed by Big Oil. It will take Congress at least a month to sort it all out.

Housing Looks Shakier Home buyers aren't the only ones getting antsy about the market. On Nov. 16 the National Association of Home Builders announced that the **NAHB/Wells Fargo Housing Market Index** fell to 60 in November, its lowest level in 2½ years. The index measures how builders see conditions. What's bugging them? Affordability is low, and mortgage rates are rising. Sellers are having a hard time facing the new reality, says George Eastment, president of Long & Foster Financial Services in Fairfax, Va., which owns brokerages in eight states: "Everyone wants to be the guy on his block who sold for the highest price."

Sic Transit Peter Drucker, management guru extraordinaire, died on Nov. 11.

See "The Man Who Invented Management," page 96

Breakup of the Week

Your average conglomerate can't get no respect these days—and after three years at the helm, **Tyco International** CEO Edward Breen seems to be losing patience. Breen has cleaned up the scandal left by Tyco's now-jailed former CEO, Dennis Kozlowski, and has tripled earnings in the past two years. His thanks? The stock fell 25% from its January high. So on Nov. 16, Breen told investors he had been talking with the board about "additional options," possibly including a breakup of the $40 billion lunker, whose businesses range from home security to electronics to health care. This mix may have worked when Kozlowski was gobbling companies to goose growth, but skeptics argue that simplicity is now the True Path. Breen says he's close to selling the $2 billion plastics business. A delighted Street bumped the stock up 4%.

EDWARD BREEN

HEALTH

AVIAN FLU: BUSINESS THINKS THE UNTHINKABLE

Executives are starting to confront the real chance of panicked workers, supply disruptions, and economic upheaval

BY JOHN CAREY

SOMETIME, SOMEWHERE, the seeds of a potential global pandemic will be sown. In Indonesia, Thailand, China, or any other country where the intimate mingling of people, poultry, and pathogens creates a cauldron of viral evolution, a bird flu bug will mutate so that it can be transmitted from person to person. And when that happens, Deutsche Bank will be ready. "The moment that there is human-to-human infection, we would execute a set of measures," says Kenny Seow, DB's business continuity manager in Singapore. The giant multinational's steps include making sure employees in infected zones don't carry the disease to co-workers, moving others out of harm's way, communicating medical bulletins to far-flung offices, and preparing for the inevitable economic shocks as mass illness slows trade and undermines both public services and private commerce.

What's unusual about Deutsche Bank is that it actually has a crisis plan for a possible pandemic. A new survey of multinational companies by *Continuity Central*, a London-based newsletter, finds that 72% have yet to begin to prepare. And an informal *BusinessWeek* poll of a half-dozen major utilities showed that none has a specific plan to keep the power flowing during a flu epidemic.

PALTRY PRECAUTIONS

BUSINESS' GO-SLOW approach contrasts sharply with the concerns of health officials, who are anxiously tracing the spread of avian flu across Asia and into Europe. Corporations don't want to panic employees or spend money unnecessarily, the way they did for Y2K. And experts say most companies don't yet realize how serious the economic effects of a pandemic could be.

Yet the impact of a flu crisis could be comparable, at least in the short term, to the Great Depression, cautions Sherry Cooper, chief economist at investment firm BMO Nesbitt Burns. Adds Robert S Wilkerson, preparedness expert at risk consultant Kroll Inc.: "If you take the Centers for Disease Control's worst-case scenario of millions infected and hundreds of thousands of deaths in the U.S. alone, corporations are just beginning to wrestle with it." In that worst case, essential services such as water or power would be disrupted, supply chains cut, international travel and trade halted, and crucial workers sickened or killed. Compared with the potential devastation, some common company preparations to date—stockpiling masks or telling employees to wash their hands—seem like whistling past the graveyard.

Increasingly, though, the threat of a global pandemic is beginning to creep into executive suites. "It's a giant leap from a year ago, when it was not on the business community's radar screen,"

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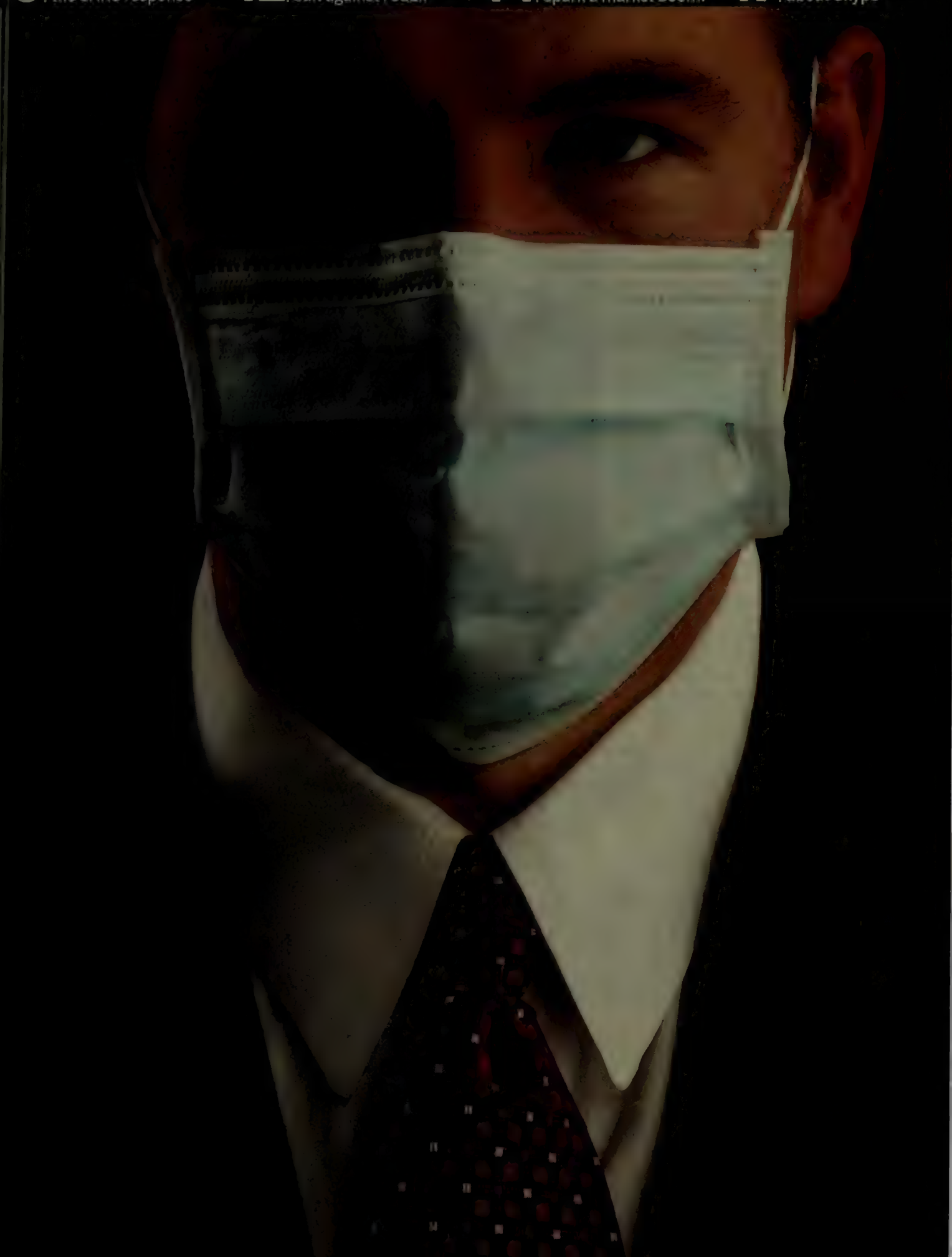

says Dorothy Teeter, director of public health for Seattle & King County, Wash. DuPont formed a 20-person pandemic team in May. With avian flu spreading, the team stepped up its pace in October and now meets every week. French construction materials company Lafarge, which lost 200 employees in Indonesia during last December's killer tsunami, has launched an avian flu intranet site to send information to distant operations. Pitney Bowes Inc. in Stamford, Conn., is ensuring that large numbers of employees can work from home. And 17 U.S. airports have or are setting up quarantine programs. The lesson from past megadisasters is that "you have to think the unthinkable," says Christian Crews, director of futures strategy at Pitney Bowes.

Planning for the unimaginable, though, is difficult. The range of possibilities is huge, from a small outbreak in Asia that's quickly snuffed out to a global disaster that undermines the basic functions of life. "At the end of the day, the pandemic threat is not just a threat to health but to the stability of the social fabric," notes Howard Pien, CEO of vaccine maker Chiron Corp.

That's why Corning Inc. is asking its business units a series of tough questions, says director of health services Dr. James Schuppert: "Could you run your facility with 30% to 40% absenteeism? Do you have the infrastructure you need?"

Clearly, business can't keep the economy running by itself. U.S. executives are counting on the federal government to fund production of vaccines and drugs to fight the pandemic if it strikes. But while Washington debates sums and strategies, there is an emerging consensus on best practices for companies (table). One broad category is finding backups for suppliers or essential work functions. "Cross-training of employees is crucial," explains Margaret Read, a crisis manager at Cingular Wireless in Redmond, Wash.

BLOOD SAMPLES Testing chickens near Bucharest, where a heron died from bird flu

Another response is keeping people apart to limit the disease's spread. That means technology and support for working from home or teleconferencing. "If [businesses] need to firm up their IT infrastructure for telecommuting, the time to do it is now, not when the pandemic hits," says Dr. Isaac Weisfuse, deputy commissioner of the New York City Health & Mental Hygiene Dept.

A pandemic could also force social adjustments. "The heroism in our culture of going to work when you're sick has to change," says King County's Teeter. Howard Lincoln, CEO of the Seattle Mariners baseball team, says he has told his employees to stay home even with ordinary illnesses. "We told people that if you come to work with the flu, it might be the last day you work at the Mariners."

That's a start. But overall, experts caution, management has to do a better job of communicating the flu threat and containment strategies. Stephen Aldrich, CEO of preparedness consultant Bio Economic Research Associates, believes that a pandemic will bring at least two economic shock waves. "The first—driven by fearful anticipation—will precede the actual arrival of the disease, and it's likely to be the larger of the two," he explains.

Indeed, fears of avian flu are already affecting business. A Kroll client recently planned a seminar in Singapore—only to have half of its instructors refuse to go. They agreed to participate only after learning more about the disease and about how they could take steps to avoid infection.

LOST WAGES

IF A HUMAN PANDEMIC were to break out, a major challenge for companies would be to provide accurate and credible information to all employees. In DuPont's war-gaming of pandemic sce-

Be Prepared

A flu pandemic could sideline up to 40% of your workforce, shut down foreign trade, and degrade public services. Health experts offer a checklist for companies:

LEAVE HOT ZONES Make plans to pull people out of countries where an epidemic strikes first, while ensuring that crucial jobs are covered.

FOCUS ON ESSENTIALS Identify your company's irreplaceable functions and figure out how to keep them going with 25% to 40% of staff coping with the illness.

STOCK UP Consider building up inventories in case foreign or domestic suppliers and transport services are paralyzed.

GO IT ALONE Prepare for breakdowns in government services such as sanitation, water, and power.

ISOLATE THE SICK Try to limit the flu's spread in the workplace by improving air circulation and filtration. Stock up on masks and sanitizers, and consider staggering work hours to limit the size of gatherings.

SPREAD OUT Give employees the equipment and support they need to telecommute if their jobs permit.

BEEF UP (JOB) SECURITY Make sure your sick leave and pay policies don't discourage workers from staying home when they're ill.

KEEP TALKING Let your employees know what you're doing—and what they should do—to limit the impact of the pandemic.

Data: Trust for America's Health; U.S. Health & Human Services Dept.

arios, "a key focus has been on ving our people timely informa- on on what is happening and hat our response will be," says r. Sol Sax, chief medical officer.

These measures, however, aise uncomfortable questions. es, people should stay home if ey are sick. But many will insist n coming in because they fear sing wages or their jobs, says im Elliott, deputy director of the onprofit Trust for America's Iealth. "Will Wal-Mart pay its ourly workers for not coming in?" she sks. Some companies have assured em- loyees that they will continue to ay wages even if sequestered staff an't work.

A different set of questions revolves around how much business should be spending on preparations. Steps such as cross-training employees or installing new networking technology for telecommuting are expensive. "It's not in the best interest of the shareholders to overinvest," cautions Pitney Bowes's Crews.

But health officials fear that a wait-and-hope approach could put the economy in a serious bind if the worst happens. "The business community, like the rest of society, is not adequately prepared," warns U.S. Health & Human Services Secretary Michael O. Leavitt. Hurricane Katrina already taught this country the perils of ignoring warnings. Unless they heed that lesson, companies in the U.S. and around the world could be in for something far more devastating if a flu pandemic materializes. ■

–With Amy Barrett in Philadelphia, Nanette Byrnes in New York, Rachel Tiplady in Paris, and bureau reports

Understanding Avian Flu—and precautions to take

"Our job is to inform but not inflame" A Q&A with Secretary of Health & Human Services Michael O. Leavitt

Corporate Responsibility 10 steps companies can take to protect employees—and their businesses

Under the Microscope A primer on avian flu

"Eerie" Discoveries about Flu How the 1918 strain helps us understand the current disease

BusinessWeek online

www.businessweek.com/extras

FLU WATCH

Prevent a Pandemic, Make a Profit

Daniel R. Dwight didn't intend to cash in on the threat of a flu pandemic. Five years ago his Belmont (Mass.)-based company, Kronos Advanced Technologies Inc., set out to make a fan with no moving parts. The secret: put high voltage across an array of wires. That creates a flow of charged particles—ions—strong enough to pull air along. Early tests, though, showed an unexpected benefit: The electrical field also rips molecules apart, destroying pathogens such as anthrax spores or flu viruses. Of course, this feature wasn't a big selling point in those pre-September 11 days. "When we said 'anthrax,' people gave a yawn," recalls Dwight.

They aren't so bored now. Kronos' virus killer "could be a hell of a device" for filtering air everywhere from hospitals to airplanes, says Peter Goelz, former managing director of the National Transportation Safety Board. Kronos has begun to talk with Korean Air and Singapore Airlines Ltd., two carriers badly hit by the Asian SARS epidemic of 2003. "We can't keep up with the calls," says Dwight.

Where there's disaster, there's opportunity for business. Consultants such as Booz Allen Hamilton Inc. and Kroll Inc. are already selling advice to business and governments on flu preparedness. Companies are stocking up on items thought to slow the spread of disease such as masks and hand sanitizers—potential sales for companies like Beijing-based Kimberly-Clark (China) Investment Co. President Stephen Shao says his company is already developing new lines of medical masks, wipes, and hand-washing liquids.

Public health officials say that with the right early warning systems, they could spot a dangerous flu strain soon enough to snuff it out. The pot of gold: $1 billion-plus that countries have proposed to spend on enhancing global biohazard surveillance. Enter Applied Biosystems, the company that made the advanced sequencers that deciphered the human genome. "We are taking capabilities developed over the last 25 years to make this early warning system available," says Christopher P. Melançon, director of biosecurity in the company's Applied Markets Div. On Nov. 8 the Foster City (Calif.) company unveiled a device that can detect the flu virus in two hours and a genetic decoding kit to find potentially deadly mutations.

VIRUS KILLER Kronos' device

Other players see an opening. By yearend, CombiMatrix Corp. of Mukilteo, Wash., plans to deliver to the U.S. Air Force prototypes of a lab-on-a-microchip device that can diagnose particular strains of avian flu in four hours.

If one of these new detectors does sound the alarm, governments will embark on a crash program to develop a vaccine. That would be good for the bottom lines at flu vaccine makers Sanofi Pasteur and Chiron Corp. "We are in possession of some key technologies that will be very, very useful in addressing a pandemic," says Chiron CEO Howard Pien.

Other possibilities for profit will surely emerge. "Crisis is an opportunity as long as you see it first," says Christian Crews, director of futures strategy at Pitney Bowes Inc. He should know: Anthrax-infected letters in 2001 created a whole new business—making the mail safe—for his company. Even a disaster such as a global flu pandemic will make someone richer.

–By John Carey in Washington, with Otis Port in New York and Dexter Roberts in Beijing

AVIAN FLU

This Time, Beijing Is Going for Transparency

BY DEXTER ROBERTS

As the bird flu crisis afflicting China worsens, Beijing has leaped into action. Even as China announced its tenth and eleventh outbreaks of avian flu on Nov. 15, Chinese scientists said they would soon begin testing a possible vaccine against human infections. Health authorities have quarantined thousands of people, set up flu inspection sites in every province, culled millions of chickens, and declared their intention to vaccinate every bird in China's poultry industry. Meanwhile, after initially stalling, Beijing has allowed a six-member World Health Organization team to join Chinese health authorities in investigating whether three people had caught bird flu in Hunan province—including a 12-year-old girl and a 24-year-old woman farmer who both have died. On Nov. 16 Beijing confirmed that at least one of those two had the virus; the third, a boy, has recovered from it. Most surprising, the government has unfettered the media to report openly on the brewing crisis.

What is motivating the mass mobilization? Beijing's top leaders are well aware that a bird flu pandemic presents a huge economic threat to China and the world. Bird flu could end up costing the global economy as much as $800 billion, says the World Bank, but Asia and particularly China and Hong Kong would take the brunt. Indeed, the Asian Development Bank predicts that a pandemic would reduce gross domestic product growth in Asia by as much as 6.5 percentage points, meaning almost zero growth for the region. In Hong Kong and China, consumption could plunge 17.3%, or $34.4 billion. China is facing a "very serious situation," warned Premier Wen Jiabao on Nov. 8 during his tour of hard-hit Heishan county in northeastern China.

And clearly the leadership recognizes that bird flu poses more than just an economic threat. As worries of a global pandemic grow, China's international credibility is again on the line, much as it was during the SARS epidemic two-plus years ago. Already tensions with the U.S. are high over everything from the value of China's currency to the trade imbalance. So this time China is twice as anxious to demonstrate that it's a responsible up-and-coming power, particularly because President George W. Bush will visit Beijing on Nov. 19-21. "Bird flu has suddenly become a global concern," says Shi Yinhong, a professor of international relations at Beijing's People's University. "It's clear that how Beijing controls it will affect their international image."

An even more crucial consideration for China's top leaders is how their handling of the crisis plays at home. President Hu Jintao and Premier Wen must keep the epidemic under control or risk seriously damaging their domestic reputations as populists. During SARS, an initial coverup and hundreds of deaths left the popular standing of the top leadership in tatters. Hu and Wen had to change tack, firing the health minister and the Beijing mayor. While that unusual move won them back support, a national disaster this time would not be so easily forgiven, and might require bigger heads to roll.

Making the situation more volatile is that China's most vulnerable population, the rural poor, are likely to be affected first. Fifty million households that work in the poultry industry have been hit as culling programs are carried out in six afflicted provinces or autonomous regions. While Beijing has promised compensation to those who lose birds, it's not certain this pledge can be met if the virus spreads nationwide. "Bird flu is the first real test of Hu and Wen's pledge to put poor people first," says Andy Rothman, Shanghai-based economist at CLSA Asia-Pacific Markets.

HOW CONCERNED? Hu's reputation is at stake

The enormity of the task appears to be behind Beijing's about-face on media coverage. Chinese reporters who initially were denied access to flu-stricken regions now are free to report openly, says Hu Shuli, editor of the muckraking financial weekly *Caijing*. That's because Beijing now realizes the press can help mobilize national awareness about the disease and make it difficult for local authorities to attempt cover-ups of any new outbreaks. "We have been playing a very active role in reporting this," says Hu. "This time the government seems to appreciate the role of the media."

The jury is out on whether the central government can keep China from becoming a launching pad for a world epidemic—the leadership's worst nightmare. Yet for now Beijing is winning public approval. "The government has been more transparent, has acted earlier, and is proving more effective compared with SARS," says Li Xudong, a PhD student at Beijing University. That's just what China's nervous leaders want to hear.

China's Bird Flu Tally

2	11	10	14
Confirmed human infections	Bird flu outbreaks across China	Million-plus chickens already culled	Billion chickens, ducks, and geese to be vaccinated

Data: *BusinessWeek*

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LABOR CLASH

THE GROUND WAR AT FEDEX

Drivers are suing to protest their status as contractors—and gaining traction

BY DEAN FOUST

BACK IN 1996, WHEN ROY Mason landed work as a delivery driver with Roadway Package System Inc., he liked the idea of being an independent contractor, instead of an employee. Although he drove exclusively for RPS out of its Arcadia (Calif.) terminal, Mason felt the company gave him wide latitude to manage his routes.

Two years later, FedEx Corp. acquired RPS, and Mason says that's when things changed. He says a new management team set out strict rules dictating everything from how he dresses to how he holds his truck keys as he approaches a customer's door. And the company imposes fines on drivers who don't meet its strict standards. A few weeks ago, Mason says, managers shadowed him on his route, then slapped him with a citation for leaving his truck door open as he sprinted to drop off a package on a customer's front porch. "They are absolutely controlling everything I do," says Mason, 49.

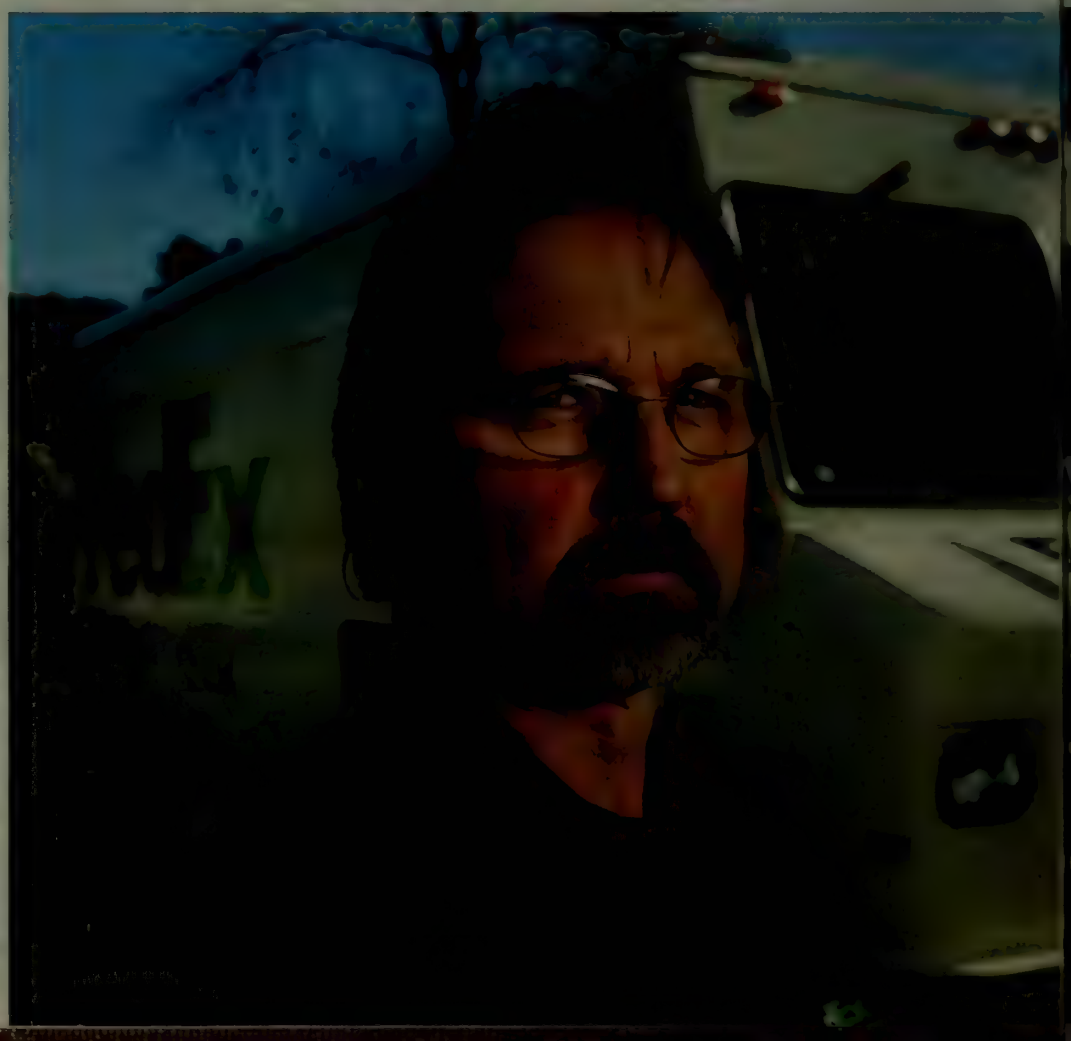
Travis Boardman begs to differ. To him, the FedEx setup is ideal for anyone with entrepreneurial drive, and the rules are necessary. A contract driver since 1993, he now has six employees who run routes for him on Maryland's Eastern Shore. He grosses $250,000 to $500,000 a year and says he nets "usually six figures."

The two men's conflicting views are at the heart of a contentious legal battle at the $29 billion delivery giant over what exactly constitutes an employee. Mason and other angry drivers have filed more than two dozen lawsuits around the country claiming that FedEx illegally classifies the 14,000 drivers in its ground division as independent contractors. They argue that because they're essentially employees, they're entitled to many of the same benefits enjoyed by the 60,000 drivers of FedEx Express, the parent's original air express service—including overtime, vacation pay, and expense reimbursement.

FedEx vigorously disagrees that they're misclassified. But right now, Mason and his colleagues are pulling ahead in the court battle. In October a California superior court judge reaffirmed his earlier ruling that among ground drivers who had filed a class action there, those who drive single routes should indeed be classified as employees. He concluded that FedEx exerts "close to absolute actual control" over them. Even as FedEx pursues an appeal, it is now under order to reclassify the California drivers. The California ruling "could be a harbinger of things to come," says Andrew P. Morriss, a business law professor at Case Western Reserve University's law school.

That ruling came on the heels of similar defeats for the company at state labor boards in California, Montana, and New Jersey in the past 18 months. Ground drivers also recently succeeded in consolidating class actions pending in 23 other states into a single case in an Indiana federal court.

FedEx officials dispute the drivers' argument and say they expect to win the appeal in California and on the broader class action. While FedEx agrees it imposes some work rules on drivers like Mason, it maintains that they aren't employees because they don't have specific start times, can buy and sell their own



SHADOWED Mason says managers monitor him on the job

PETER DASILVA

utes and trucks, and can hire and fire nployees. It argues that, like Boardman, ost ground drivers prefer the status o, which allows them to acquire multi- e routes and—like business owners— re employees to drive for them.

Indeed, roughly 20% of its ground ivers manage multiple routes, FedEx ys. And 300 of them grossed more than 250,000 in 2004 by expanding their utes that way. "This [business] model s been validated in more than 100 reg- atory reviews," says Robert Ostrov, ce-president of contractor relations for edEx Ground.

ISTINCT ADVANTAGE

TILL, THE COST of a defeat could be eep. Suits over independent contractor atus have bedeviled companies ever nce Microsoft Corp. lost a major battle ver the issue in 2000, forcing it to make $97 million settlement that sharply urbed its use of contractors. Since then, ther companies striving for more flexible bor, such as Hewlett-Packard Co. and erizon Communications Inc., have been nsnared in legal battles over how to dis- nguish a contractor from an employee.

For FedEx, the contractor model may e one reason why it has taken market hare from archrival United Parcel Service Inc., whose drivers are largely full-time employees, says Satish Jindel, president of SJ Consulting Group Inc., a transportation consultancy. He estimates that the use of lower-cost contract drivers enables FedEx Ground to deliver packages for an average cost of $5.82 apiece, vs. the $7.17 average Jindel believes it costs UPS to deliver both air and ground packages over its integrated network. FedEx won't discuss Jindel's estimates but says its contract drivers "are more productive because they get paid by results, not by the hour."

Many FedEx drivers manage multiple routes and gross more than $250,000 a year

The cost differential has helped FedEx Ground's share to jump from 13% to 18% since 2000, even as UPS has slid from 82% to 74%, estimates Jindel. By using independent contractors—who can't legally organize into a union—FedEx also has avoided labor strife, such as a messy 1997 Teamsters strike at UPS.

Plaintiffs' lawyers argue that if the company is forced to reclassify them as employees, it would have to pick up the tab they now pay for workers' compensation, unemployment insurance, and Social Security contributions. FedEx wouldn't be legally obligated to pay all the other benefits enjoyed by UPS drivers. But it could face internal pressure to extend the same health and retirement plans it provides to air drivers. Plaintiff attorney Lynn Rossman Faris of Oakland, Calif., who filed the California class action, asserts in the suit against FedEx that the company could be on the hook for more than $200 million a year. And if the company were forced to buy back drivers' trucks, that would represent a one-time expense of $630 million, says Faris, who calculates that drivers currently buy the vehicles at an average cost of roughly $45,000 each. In response to Faris' calculations, a FedEx spokesman says, "we wouldn't even speculate because we're confident we're going to prevail. Any guestimate is far too premature."

What's more, Mason and other plaintiffs say that though FedEx' rules leave room for some drivers to be enterprising, there's little freedom. They can't deliver for other companies, can't skip a day without finding an approved substitute, and can be fired if they run afoul of the many rules. "They told me what time to be at work and when I could go home," says Gerold Pelkey of Sauk Centre, Minn., who drove for FedEx Ground between 2000 and 2003 and is a party to one suit. "From the get-go, I was faced with termination if I didn't handle as many stops as they wanted."

Nor did he make the $50,000 to $55,000 a year FedEx says a typical driver earns after expenses, he says. Interest on the loan for his route and truck, plus maintenance costs, says Pelkey, left him with $20,000 a year. "My income was so low I qualified for the earned income tax credit two of the years I worked there," he recalls.

For now, the case pending in Indiana poses the biggest challenge to FedEx. The outcome may determine whether disgruntled drivers like Mason or advocates like Boardman have the right of the road. ■

Independent or Employee?

Lawsuits by FedEx drivers claim the company illegally classifies them as independent contractors. FedEx says that's what they are. The distinction is key to its rivalry with UPS.

FEDEX GROUND	UNITED PARCEL SERVICE
DRIVERS 14,000, all independent contractors	60,000 employees, members of the Teamsters union
PAY $50,000 to $55,000 a year, after they pay for their truck and other expenses	$50,000 to $55,000 a year
BENEFITS None paid by FedEx. Drivers pay taxes for workers' compensation, unemployment insurance, and Social Security	UPS offers medical care, pension, 401(k), and pays for overtime, holidays, and vacations
EXPENSES Drivers pay for truck purchase or lease, fuel, maintenance, and uniforms	All driving costs paid by company.

Data: *BusinessWeek*

FOREST GOLD Koch Industries is paying a 39% premium for Georgia-Pacific

WALL STREET

THIS SPREE COULD SPUR A STOCK SURGE

Private-money purchases of public companies recall the '80s boom in deals

BY PETER COY

THE STOCK MARKET RUNS on money and psychology. Find deep-pocketed investors who think they see value where others don't—and will put up the bucks to prove it—and you are well on the way to lighting a fire under stock prices.

In the 1980s the role of fire-starter was played by leveraged-buyout firms, which made deal after deal, each one bigger than the last. Fueled by junk bonds, their free-spending ways helped the stock market soar. Even after the LBO craze ended with a wave of defaults and indictments, the stock market kept virtually all of its gains.

Similarly, today's cash-rich buyout funds and private corporations are showing themselves willing to pay handsomely for control of entire public companies. This influx of money could set the stage for a broad upsurge in the stock market, especially since the takeovers are helping to shrink the supply of public securities available for other investors.

The latest play: Koch Industries Inc., the giant family-run company that agreed on Nov. 13 to pay a hefty premium of 39% over the pre-deal price to acquire Atlanta-based papermaker Georgia-Pacific Corp. Coming down the pike is a likely buyout of Computer Sciences by Lockheed Martin and three private firms, and Knight-Ridder's possible takeover by private-equity firms after the newspaper chain put itself up for sale on Nov. 14. On Nov. 16 conglomerate Tyco International Ltd. announced it might sell itself off in pieces to unlock shareholder value.

HALO EFFECT

THERE'S PLENTY MORE to come. Buyout funds raised money at a $68 billion annual rate through September, compared with $46 billion in 2004, according to Thomson Venture Economics and the National Venture Capital Assn. Blackstone Group is raising a $12.5 billion megafund, Thomas H. Lee Partners a $7.5 billion fund, and Madison Dearborn Partners a $5 billion fund, to name three. "We are probably in the middle" of the buyout cycle, says Steven N. Kaplan, a University of Chicago economist. He calculates that fund-raising by nonventure partnerships—including buyout funds—now adds up to more than 0.5% of stock market capitalization. That may not sound like a lot, but it's getting close to the peak of the '80s frenzy.

It's not simply that private buyers are paying up to get full control of companies. Purchases also have a halo effect on other players in the same industry. Eddie Lampert's purchase of Sears, Roebuck & Co. stimulated interest in department stores. Now, Koch's purchase of Georgia-Pacific has helped bump up the stock prices of International Paper and Weyerhaeuser. "Something about a private firm buying a publicly traded company gets everybody excited, wondering if they know something we don't know," says Edward Yardeni, chief investment strategist of Oak Associates Ltd., an Akron money manager.

For an inkling of the impact of buyouts so far, take a look at how fast shares are disappearing from the public markets. In the first half of 2005, the combination of buyouts, stock buybacks, and other deals gobbled up $260 billion of nonfinancial corporate equity at annual rates. This flow of money buying up stock is only a little less than a more familiar source of stock purchases—the $288 billion annual rate of household investment in mutual funds in the first half of the year.

Not everyone thinks private buyout action is powerful enough to lift the entire stock market. Stefan Selig, vice-chairman for global investment banking at Banc of America Securities, says the impact is being felt mainly in sectors with many "LBO-able" companies—ones with steady cash flows and low price-earnings multiples.

But even if buyout funds don't buoy all stocks, they can put a floor under prices through their willingness to snatch up undervalued companies. That wouldn't be as good as a stock market boom, of course, but it might help ordinary investors sleep better. ■

Factors That Could Fuel the Market

LESS SUPPLY Amount of nonfinancial corporate equity taken out of the market in the first half of 2005*		**MORE DEMAND** Amount raised by U.S.-based private-equity buyout funds in the first nine months of 2005**	
$260 BILLION	115% CHANGE FROM YEAR EARLIER	$68 BILLION	50% CHANGE FROM YEAR EARLIER

* Annual rate, including buyouts and stock buybacks
** Annual rate

Data: Federal Reserve, Thomson Venture Economics/National Venture Capital Assn.

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Talk with your doctor first. Make sure you are healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, seek medical help right away. Although erections lasting for more than four hours may occur rarely with all ED treatments in this drug class, it is important to seek immediate medical attention. Erections lasting longer than six hours can result in long-term loss of potency.

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Please see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.
*Percent of members by formulary status for HMOs, PPOs and POS for Viagra, Levitra, and Cialis. *Formulary Compass*™ MediMedia USA, Inc. February 2005.

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This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?
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• How Sex Affects the Body
When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works
VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone
As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do
- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV — the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA
Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have ever had severe vision loss
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines
Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You
VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA
Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects
Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side-effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose
In case of accidental overdose, call your doctor right away.

• Storing VIAGRA
Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA
VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

U.S. Pharmaceuticals

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THE INTERNET

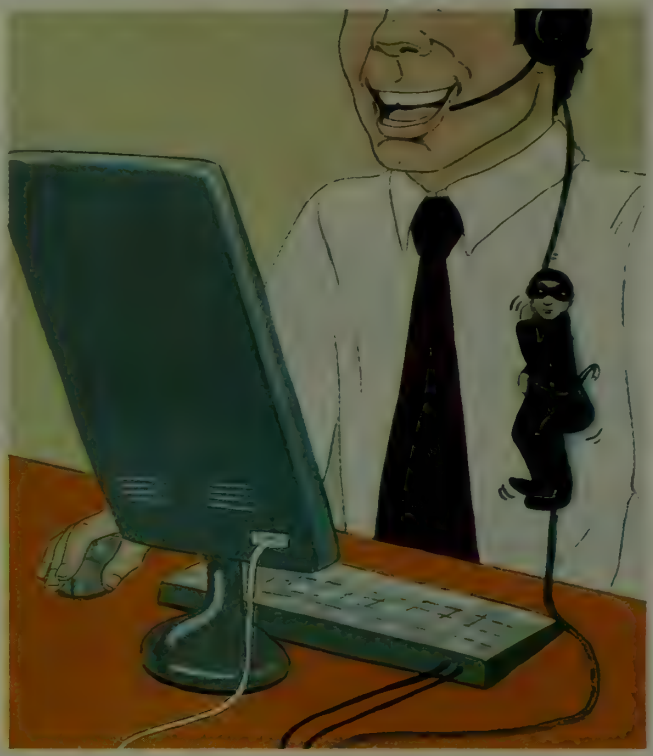
GETTING SKITTISH ABOUT SKYPE

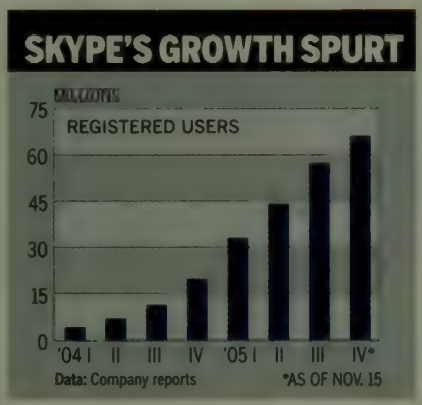
Security questions have some companies steering clear of the Internet phone service

BY ANDY REINHARDT

IT'S THE KIND OF NOTORIETY that comes with a $2.6 billion buyout. Since Luxembourg-based Internet telephone startup Skype Technologies was gobbled up by online marketplace eBay Inc. for that princely sum in September, Skype has added 12 million more users, for a total of 66 million—and has attracted a boatload of closer scrutiny.

Most troublesome are questions about whether Skype's technology is safe to use inside corporations. The company's popular software lets people make free calls over the Internet from one PC to another. But in recent days consultants have begun warning companies that employees who use the software in the office could be poking holes in the security systems designed to defend against hackers and other intruders. On Nov. 10, Info-Tech Research Group in London, Ont., issued a report under the headline "Ban corporate Skype usage immediately" that cited a litany of potential security risks. Tom Newton, a product manager at Smooth-Wall Ltd., a maker of corporate firewalls in Leeds, England, says: "We advise customers to keep it off their networks."





What makes Skype a potential risk is the very thing that makes it so appealing to millions of users: It's a breeze to set up. Unlike more complex and expensive Internet phone offerings from the likes of Cisco Systems Inc. and Avaya Inc., Skype can be downloaded and installed by any employee, beyond the control of info-tech managers. What's more, Skype is designed to burrow past firewalls while leaving little trace of its presence. The software works like a charm, but the hole created for phone conversations could be exploited to swipe data or release viruses.

There have been no reports of attacks that take advantage of Skype technology. Yet the company itself concedes its product may not be right for some organizations. Michael Jackson, Skype's director of operations, strongly defends the software's safety and data encryption, but he acknowledges it lacks features such as the ability to log and monitor phone calls. Avoiding Skype may thus be "the right thing to do," Jackson says, for companies facing stringent compliance requirements under the Sarbanes-Oxley standards now necessary at publicly held U.S. companies.

CAMPUS PARIAH

SOME ORGANIZATIONS are clamping down. Pharmaceutical giant Novartis in Basel, Switzerland, doesn't let employees use Skype. Neither do Goldman Sachs and German chemicals giant Degussa. A growing number of schools ban the technology, including Oxford University, the University of Texas, and the University of Minnesota. In September the French government recommended research personnel at universities and government labs avoid using Skype.

Does this mean eBay paid a fortune for a lemon? Not at all. Individuals who pay for their own phone calls are fanatical about the technology. So are small-business owners who watch every dime and don't much worry about security. "It's free. Next?" says Munjal Shah, chief executive of a 22-person photo search service in Redwood City, Calif., called Ojos Inc. that uses Skype to converse with its 10 staffers in India.

Even some larger companies aren't breaking a sweat. Ken Andre, chief information officer for Greif Inc., a $2.2 billion maker of industrial packaging products in Delaware, Ohio, says he has tested Skype and isn't concerned. "If I were George W. Bush, I wouldn't talk on it," he says. "But it should be fine for anybody else."

Skype is working hard to close up potential vulnerabilities. Earlier this year the company hired independent security expert Tom Berson to conduct a four-month audit of the technology. Two problems found during the examination were fixed in October. Berson rated Skype secure and reliable. Companies with the most stringent standards will probably steer clear of the service. But as long as hackers don't manage to concoct a Skype attack, everybody else should be able to enjoy lots of free Internet gabbing without anxiety. ■

–With Robert D. Hof and Ben Elgin in San Mateo, Calif.

Oolitic, Indiana, an hour shy of sun-up and a farmer is getting to work.

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EDITED BY RICHARD S. DUNHAM

The Health-Care Crisis: States Are Rushing In

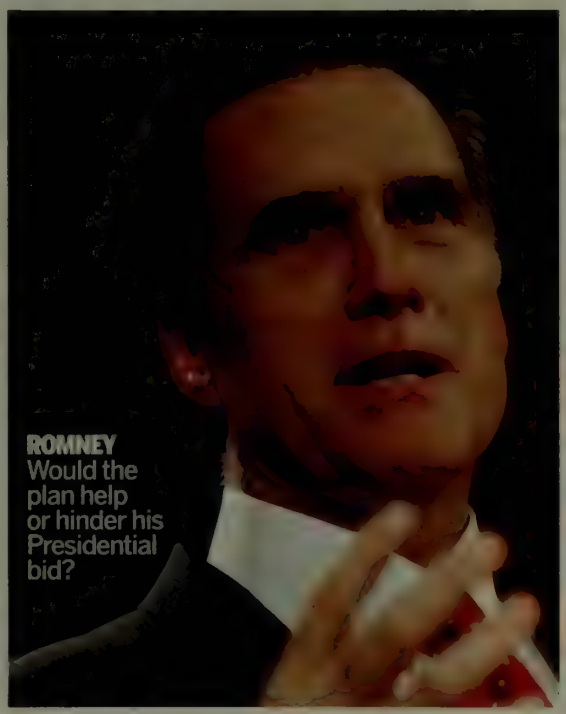
HEALTH COSTS ARE SKYROCKETING, the number of uninsured is growing steadily, and squeezed companies are bailing out of the benefits business. Yet Washington is sitting on its hands. Enter the states. Governors and legislators are trying in a variety of ways to expand coverage while reining in their own expenses.

Business is watching warily to see whether states can achieve health-care nirvana: widespread coverage and lower costs without steep, job-crushing taxes.

The hottest debate is in Massachusetts. On Nov. 3 state representatives passed a bill that would achieve near-universal coverage by making their state the first to impose a so-called individual mandate—a requirement championed by Governor Mitt Romney—that directs all residents who can't get coverage at work or from Medicaid to buy their own insurance. In Illinois, Democratic Governor Rod Blagojevich on Nov. 15 signed into law his $45 million "All Kids" plan, which would make the Land of Lincoln the first to extend comprehensive coverage to all children under age 18. And in 2006, 22 states across the political spectrum will be expanding eligibility for Medicaid programs, according to the Henry J. Kaiser Family Foundation.

Increasing health coverage is a laudable goal. But visionary governors should study the results of past state experiments. Hawaii launched an employer-financed universal-coverage plan in 1974, but today up to 12% of its residents still remain uninsured. Tennessee tried to expand coverage dramatically in 1994 with a massive state-run insurance program called TennCare, but its staggering costs fueled a taxpayer backlash. And California dropped plans to require employers to cover workers or face new taxes because of widespread opposition from the business community.

Yet Romney thinks a more market-based solution to the health-care crisis can be a winning issue. The Republican governor is expected to announce his Presidential candidacy before Christmas and figures expanding coverage could win him praise as a can-do compassionate conservative. Rather than force employers to provide coverage, he would require individuals who don't qualify for Medicaid to buy their own health insurance. Massachusetts would encourage insurers to offer less expensive but more restrictive policies costing about $200 a month, or half current levels. The state would help subsidize the cost for people earning less than triple the poverty level. Those who don't buy insurance would face stiff tax penalties—a stick designed to encourage participation. House Speaker Salvatore F. DiMasi, a Democrat, estimates the plan would extend coverage to 95% of the 500,000 residents who are now uninsured. "This could become a model for other states," he predicts.



ROMNEY Would the plan help or hinder his Presidential bid?

Business is wary of a statehouse push for widespread coverage

Pack-Up Time?

BUT HEALTH PLANS that work on paper often fail in the clinics. The individual mandate could create a backlash among healthy young singles who often choose to go without insurance. And DiMasi's troops in the Democratic-controlled Massachusetts House are adding a wrinkle that is strongly opposed by business: a 5%-to-7% payroll tax on companies that don't insure their own employees. "This would clearly undercut job creation at a time when we are already a very high-cost state," says Michael J. Widmer, president of the Massachusetts Taxpayers Foundation, a business-oriented research group. And for employers who already provide coverage, the tax could prove a cheaper alternative, inducing them to dump workers onto the state plan as costs rise.

Romney, who knows his 2008 prospects could vanish if he endorsed a steep tax hike, is counting on the state Senate to nix the tax: It's pushing a less sweeping plan that would cover no more than half the uninsured. "If you try to do too much, too fast, you end up with nothing," says Senate President Robert Travaglini (D).

Even that modest progress could prove appealing to voters in states where coverage is shrinking. Slammed by increasing health-care costs, 14 states—almost all of them carried by George W. Bush in 2004—are scaling back their Medicaid programs. Tennessee has already slashed 200,000 from TennCare, and Missouri has cut some 100,000 residents off Medicaid.

Over the past five years, the number of companies offering insurance has fallen from 69% to 60%, says Gary Claxton, a Kaiser vice-president. Where coverage is offered, premium hikes have more employees opting out. The upshot: The number of uninsured rose from 15.3% to 18% between 2000 and 2004. Faced with those facts and with Washington's inaction, governors like Romney and Blagojevich feel they have little choice but to ignore the grim record of state reforms and take action on their own. ■

–By William C. Symonds in Boston, with Howard Gleckman

INDIA

CISCO: SOLD ON INDIA

The networking giant sees an edge there, even with most competitors resolutely set on growth in China

BY PETER BURROWS AND MANJEET KRIPALANI

BACK IN EARLY 2003, CISCO Systems Inc. executive Rangu Salgame hopped into a taxi at Bombay Airport and struck up a conversation with the driver. Returning to his native land to work for the first time in 20 years, Salgame was thinking of taking the helm of the networking giant's India operation.

At that point, China was the focus of Cisco's Asian energies, and the India operation was a Cisco backwater. Making it big enough to matter to the massive company would be a huge challenge. Salgame figured he would start his due diligence right in the cab. "So how's life in India these days?" he asked, expecting the usual litany of woes. To his surprise, the driver answered: "Pretty good. My children are at school, doing well and learning English. I earn O.K. For the first time, I am feeling there's a future in India."

That was the start of what has become a love affair between Cisco and the Indian market. Salgame took the job, and after three months of intensive research he came to the conclusion that India was on the cusp of a major economic leap. "I had no time to waste," Salgame recalls. "Once you spot a market transition, you've got to go for it."

Salgame and his staff wrote a report to Cisco CEO John Chambers asserting that India's telecom, technology, finance, and other companies were ready to spend big bucks on upgrading their information technology networks. Within months, Salgame had secured permission to triple his sales staff and boost the company headcount from 1,000 to 1,400. Just two years later analysts estimate he has a $550 million business—and that it will hit $1 billion by 2008. Last month, Chambers announced $1.1 billion in new investment in Cisco India (page 92).

And Cisco's China business? On Nov. 9, in a conference call, Chambers made a striking prediction: "It would not surprise me to see India actually challenge China, in terms of our business revenue, [in] three to four years."

Chambers' statement certainly goes against conventional wisdom. After all, China boasts a $1.6 trillion economy that's growing at a 9% annual clip, and it's the world's largest market for many products. India, with the same 1 billion-plus population, has a $700 billion economy that's growing at 7%.

Cisco itself has been a major beneficiary of China's buildout. From the late 1990s through 2003, China's massive state-controlled phone companies built nationwide networks that connected more than 30 million homes, and Cisco profited greatly. Many Western companies, meanwhile, are banking on China remaining their single biggest source of new growth. Says Meichun Hsu, a Hewlett-Packard Co. executive who will run a new research and development lab in Beijing: "China's potential is greater than India's for the next decade, even though India could be the bigger economy in the next 25 years."

Cisco, though, is betting that India's growth rate is going to pick up smartly—in part because deregulation of its telecom industry is leading to vast investments in new Internet infrastructure. "We are witnessing the advanced stages of an enormous evolution of the market as the government rolls back state control and as the economy becomes liberalized," says Cisco Senior Vice-President Daniel Scheinman. That creates a huge new opportunity for Cisco with big phone companies, including state-owned BSNL as well as private players such as Bharti and Tata Group. That, in turn, could create massive demand

A Tale of Two Countries

In the race for foreign investment between India and China, Cisco is betting that India will pull away in the years ahead

BANGALORE Testing VoIP products

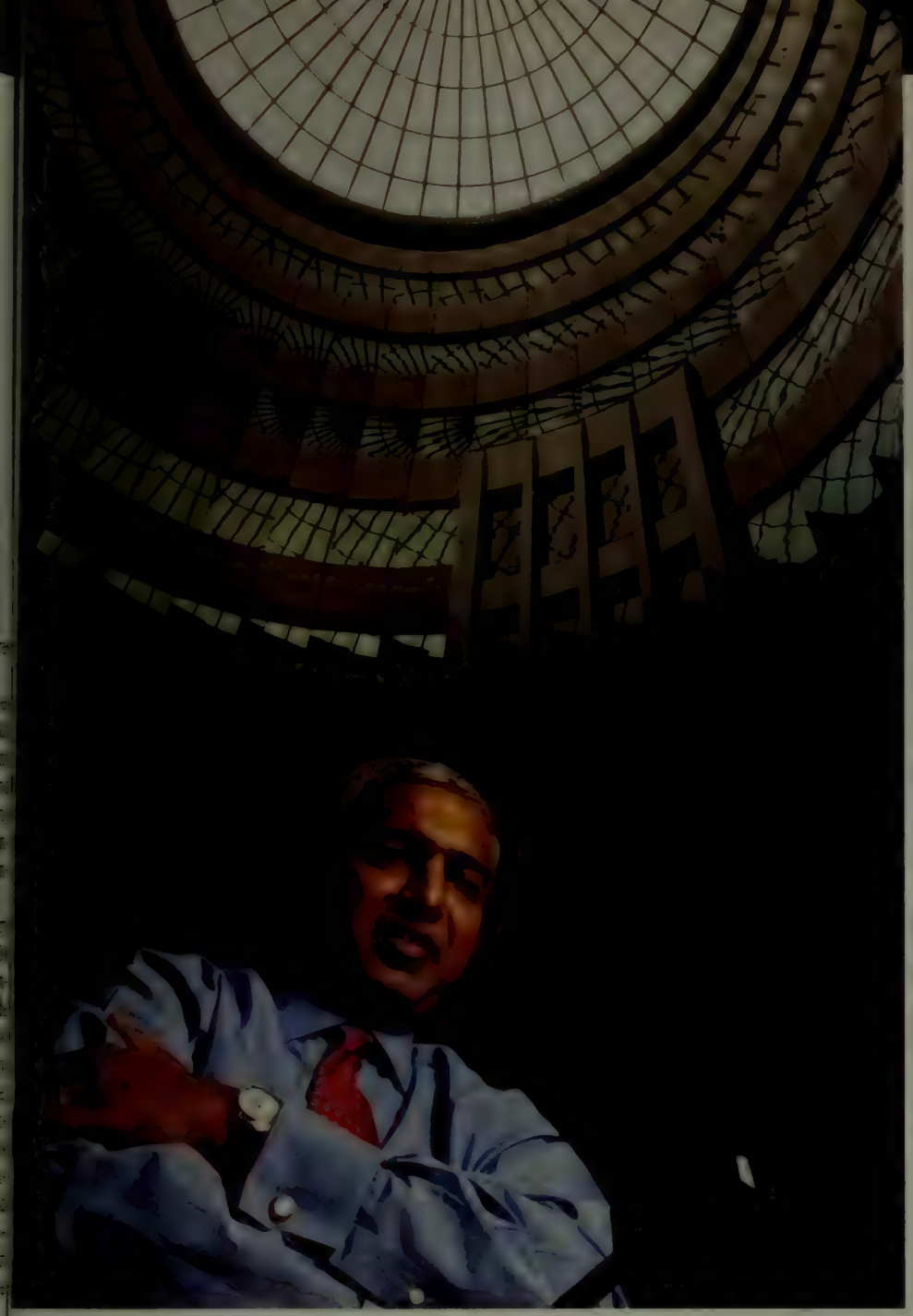
WHAT CISCO LIKES IN INDIA...

- India's **unregulated economy**, which means lots of entrepreneurial activity and new companies for the acquisitive giant to invest in.
- India's excellence in **software design** and services, which make it the perfect outsourcing and R&D partner.
- The strong need for Cisco's **networking gear** in telecom, manufacturing, banking, and other fields.
- India's **less competitive environment**—Cisco controls 74% of the market.

...AND WORRIES ABOUT IN CHINA

- China's **centrally planned economy**, which tends to make big infrastructure investments in waves. Cisco thinks there may be a trough in years to come.
- The **loans and other support** Beijing gives to favored domestic companies such as Huawei, which compete with Cisco.
- China's less-than-rigorous **intellectual-property protections**, which put Cisco's patented products in jeopardy.

Data: BusinessWeek



SALGAME
He saw a market in transition

as India's consumers and growing corporate sector snap up gear to make use of these cutting-edge networks.

While Cisco says it's not reducing its commitment to China, it perceives that China's centrally controlled economy is taking a breather. Beijing recently delayed a $6 billion-plus disbursement related to construction of a new 3G wireless network. What's more, Cisco sees a wave of Indian entrepreneurship that, together with tougher laws on intellectual-property rights, will make the nation an attractive place to set up R&D and venture operations. Cisco is not alone in this view. Many multinationals, especially those that were late to the game in China and are struggling to figure out its political and cultural complexities, are also looking to hedge their bets by investing in India.

In China, meanwhile, the picture is hazy. Cisco faces pressure from scrappy homegrown rivals such as Huawei Technologies and Harbour Networks Co. By undercutting Cisco's top-shelf prices by as much as 50%, the locals have helped take a bite out of its market share, which has dropped from 75% in 2001 to some 48%, according to market researcher IDC. While it posted nearly 30% growth in China in its most recent quarter, the company could be hard-pressed to maintain that pace.

India, on the other hand, grew 70% in the most recent quarter and should continue to grow at 40% or more in coming years. Cisco's share of the India market: 74%. "In China, you've got Huawei. In India, you've got nobody," says JMP Securities LLC analyst Samuel C. Wilson.

India is embarking on a broad expansion of its networks

Part of Cisco's China problem is that Wall Street insists it sustain its sky-high 68% gross margins, which makes it difficult to match rivals' low prices. "The [corporate technology market] in China is tough," says Thomas F. Mendoza, president of storage gear maker Network Appliance Inc. "The promise is there, but very few are making money."

BUILDOUT BONANZA

IN INDIA, BY CONTRAST, Cisco has an almost blank slate. Only 550,000 homes are connected via broadband in India, vs. 30 million in China. India's Ministry of Communications & Information Technology hopes to reach 12 million homes by 2010. Because so much of India still lacks phone lines, many carriers are installing higher-capacity Ethernet cables all the way to residences—the same cables found on Cisco office and consumer gear. Indeed, the Indians are willing to pay Cisco's higher prices to create gee-whiz new networks. Jagbir Singh, chief technical officer for cellular giant Bharti, says "most of our customers have Cisco [gear], so it's easier to interconnect with them" through Cisco networks.

Meanwhile, longstanding suspicions between India and China are hurting Cisco's rival Huawei. Recently, India Technology Minister Dayanidhi Maran expressed concern that Huawei might leak militarily sensitive information about India's infrastructure to Chinese officials. In October, BSNL accused Huawei of failing to live up to its obligations on a big network contract. Huawei, which has a large R&D center in Bangalore and is considering other investments, would not comment on the allegations. But it could be banned from bidding on BSNL contracts for a period of time.

That's just one more reason why India looks good to Cisco right now. And Cisco knows something about trendspotting. After all, that's how it caught the wave in China. As Cisco shifts its focus to India, someone is going to learn a tough lesson: Cisco, if it leaves too much business on the table in China; or its rivals, if Cisco has guessed right about what it believes is the best growth market of them all. ■

–With Bruce Einhorn in Beijing

THROUGH THE ROOF Freer lending has fed a housing boom

MEXICO

IT'S FIESTA TIME FOR THE BOLSA

Foreign investors are enjoying the party as Mexico's market jumps

BY GERI SMITH

MEXICO IS HOT, SIZZLING hot. The Bolsa index is up 31.1% this year in dollar terms. And U.S. investors are tumbling in, eager for returns that would do a hedge fund proud. "These are magnificent times," says Selene Avalos, chief financial officer of Urbi, a housing developer based in Mexico's Baja California capital of Mexicali. Avalos is touring the U.S. and Britain trumpeting Urbi's prospects to institutional investors. They love the story: Urbi's share price has advanced 56.8% this year.

More than a decade after Mexico's last big crisis, the country is in a sweet spot. Public finances are in excellent shape, and government debt carries an investment-grade rating. Although manufacturing sales to the U.S. are sluggish and will keep growth to 3% this year, oil exports are bountiful, interest rates are low, and expanded bank lending has kept consumption rising. Foreign currency reserves are at an all-time high of $65 billion. As a result, since late 2000 the Bolsa has gained 130% in dollar terms, while the Standard & Poor's 500-stock index has slid 13%.

Foreign buyers, many of them from the U.S., are taking part in the runup: Almost 45% of Mexican shares are owned by outsiders. "When global investors decide they want a little action, they look for liquid stocks whose names they recognize, and the apocryphal dentist in Kansas City has probably heard of Telmex, Televisa, Cemex, and Femsa," says Geoffrey Dennis, Latin America equities strategist at Citigroup in New York.

The other trend drawing in money is a housing boom. The mortgage market was once almost nonexistent, since periodic financial crises would push debtors into default. Now banks are offering 20-year loans to middle-income buyers, and the government is building record amounts of housing for the working class. This year 750,000 mixed-income houses will be built, boosting the shares of Urbi, GEO, and Desarrolladora Homex, three of the biggest developers. All told, Mexico still has a deficit of 4 million homes. "The demand is there, private and public financing is there, and the political backing is there," says Todd McClone, co-manager of the Emerging Markets Growth Fund of William Blair & Co., a Chicago investment firm that is Urbi's biggest investor. "That's a growth story that can last 10 years and beyond."

POLITICAL CALM

THE MARKET IS further buoyed by the 65 Mexican companies that trade easily in the U.S. as American depositary receipts (ADRs). Among the best-performing is América Móvil, the regional cell-phone business run by billionaire Carlos Slim; its shares are up 55.4% this year. Wal-Mart de México, which already has 751 supermarkets, wholesale clubs, and restaurants in the country, has seen its share price rise 53.7%. Even though cement giant Cemex earns 80% of its sales abroad, the domestic building rush has helped push its stock up 47.7%. "No wonder you've had this flood of money coming in," says Citigroup's Dennis.

In the past, Mexican presidential elections could be counted on to trigger an economic crisis. But the 2000 vote went smoothly, and the upcoming 2006 election hasn't caused tremors, even though front-runner Andrés Manuel López Obrador leans left. A victorious López Obrador would not command a congressional majority and so would not be able to make radical policy changes. Moreover, Mexico now has an independent central bank to keep an eye on monetary policy.

The one thing that could give the Bolsa a jolt would be a sharp drop in oil prices, since oil exports mask a deteriorating trade balance. But no one is predicting such a plunge. The Bolsa will undoubtedly sag some day, but for foreign investors it's still an attractive place to visit. ■

Hot Stocks South of the Border

Mexico's housing developers are among this year's top performers...	GEO	+55.5%
	URBI	+56.8%
	HOMEX	+29.8%
...and are helping drive up the overall stock market	IPC stock index	+31.1%

All percentage gains year-to-date, in dollars **Data:** UBS Securities

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HIS BABY Bach has steered Xbox to solid success

Robbie Bach Is Ready to Rumble

The honcho of Microsoft's Xbox 360 heads for a bare-knuckles brawl with PlayStation

BY JAY GREENE

IT'S 5:50 ON A NOVEMBER MORNing, and Robert J. Bach is shooting hoops with some pals in the Pro Sports Club in Bellevue, Wash. Microsoft Corp.'s top entertainment technology executive has a severe case of bed head, but he's full of intensity in the game of three-on-three, with a group made up mostly of current and former Microsofties. Every few minutes, the gregarious 6-ft.-3-in. Bach, known as Robbie, acts as human scoreboard, rattling off the point tallies. "23-21, us," he belts out. "The man wants to win—a lot more than most," says longtime friend and former Microsoft colleague Frank M. "Pete" Higgins. "Keeping score isn't extra work for him."

For anyone keeping score at home, Bach is out in front. As the company's chief Xbox officer, he gets a lot of credit for the solid success of Microsoft's game console. In the four years since its launch, Xbox has captured the No. 2 spot—Sony Corp.'s PlayStation 2 is tops—and expectations are running high for a second-generation video console, Xbox 360, which will hit North American stores on Nov. 22. Xbox 360 comes in a sleek white console, boasts high-definition gaming, and easily connects to a home computer network.

Most analysts believe the new version, with a $299 price tag for a base model, will help Microsoft narrow the gap with Sony. The Japanese company still dominates the market, and PlayStation 3 is expected to have life-like graphics, thanks to its Cell multimedia chip. But Sony won't launch PS 3 until sometime in 2006. That has Bach salivating. Xbox was the latecomer to the market last time. "I've lived this entire experiment from the other side," Bach says. "There's nothing like being on the other side to know what it feels like and what the challenges are."

In recognition of Bach's talent and the importance of consumer electronics to Microsoft's future, CEO Steve Ballmer on Sept. 20 named him one of the company's three new presidents. Bach runs the new Entertainment & Devices Div., which includes Xbox, game software, and technol-

y for devices such as mobile ones. "He is a strong business ıder who understands the im-rtance of creating a strong d-to-end experience for con-mers and making tough deci-ons and trade-offs when re-ıired," says Ballmer. At 43, ıch is the youngest of the pres-ents, perhaps putting him in ıe to succeed 49-year-old allmer one day—although ıch says it's not something he ıs considered.

He would make an interesting ıoice. Bach has emerged as a idge between Microsoft's past ıccess and future ambition. A -year veteran of the software ant, he spent four years run-ıg marketing for Office, the ompany's ubiquitous software r word processing, spread-ıeets, and presentations. Now ith Xbox, he has led Microsoft ıto a new multibillion-dollar business, ıe type the company is desperate to find s growth of its mature products slows.

To succeed, Bach broke the Microsoft ıold. While almost all of the company's ther products are linked to Windows, Iicrosoft's operating system for PCs and ther devices, he built Xbox without us-ıg the flagship product, focusing solely n making it a great game console.

These days, he seems poised to use that laybook as he goes after additional mar-ets. One area of interest: digital music. ach says the company, which already ıakes software for playing digital tunes, ıight consider making its own digital ıusic player to rival Apple Computer nc.'s iPod. That would be a big change ince Microsoft historically has won sup-ort from hardware makers by sticking to oftware. Making a music player would ut Microsoft into competition with Dell nc., Creative Labs, and others that use its udio software. Still, Bach might be moti-ated to change course since Apple has eft all other rivals in the dust.

Bach can be an extremely dangerous ival. He's able to tap Microsoft's billions o go after new opportunities. In the Xbox usiness, Microsoft has burned through 3.8 billion since it first started working n the project in 2000, estimates analyst Rick Sherlund of Goldman, Sachs & Co. Sherlund doesn't expect the home and ntertainment group to turn a full-year rofit until at least fiscal 2008.

Microsoft has been willing to invest hat kind of money because Bach's busi-ıesses have the potential to be the en-

CUSTOM COVER 360 buyers can pick colors and designs

gines of future growth. Right now, they amount to just 9% of the company's $40 billion in annual sales. But Sherlund estimates sales in Bach's home and entertainment group, the Xbox business, will jump 56% this fiscal year, and his mobile device division will climb 25%—compared with just 6% for the Office products. That's one reason the Xbox group is among the most popular spots to work in Redmond. It's a new frontier, and workers get to be the underdogs.

Bach has already made a dent in Sony's game dominance. The first Xbox console captured 18% of the market, compared with 67% for PlayStation 2 and 15% for Nintendo Co.'s GameCube, according to researcher DFC Intelligence. It's surprising to many in the industry who wrote Xbox off early, figuring that Microsoft would alienate game makers with the kind of heavy-handed tactics it was known for in the PC business. "Robbie has achieved a massive amount of credibility for a company that a lot of people were suspicious of," says John Taylor, a video game analyst at Arcadia Investment Corp. in Portland, Ore.

Bach developed his strong work ethic as a kid. He spent his early years in Milwaukee and moved to Winston-Salem, N.C., at 13. He grew eight inches the year before, leading to a condition known as kyphosis, a curvature of the spine. Three days before moving, he got a brace with steel rods connecting from a girdle at his waist to a metal ring around his neck. He wore the contraption for five years, initially for 23 hours a day. "It was a huge hassle. Everyone looks at you kind of funny," Bach says. "I grew up quicker than a lot of people."

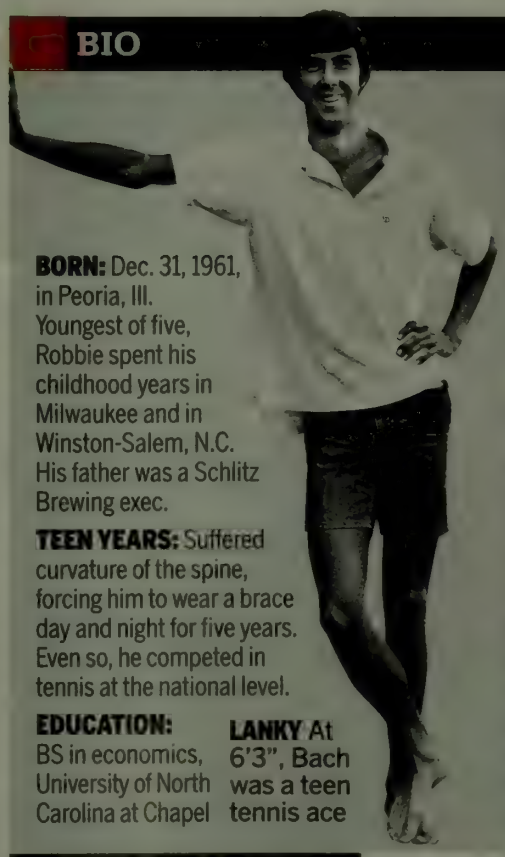
CONFIDENT

THE BRACE DIDN'T do much to slow Bach down. "Robbie looked at it and said: 'No big deal,'" recalls brother Tom Bach. A gifted athlete, Bach played tennis six days a week wearing the brace. And he excelled, reaching the quarter-finals in doubles at the national boys tennis championship in 1978. "He was so driven to play tennis wearing that thing," says his then-practice partner, Louise Allen. 'Everything he got, he earned." Bach rarely plays anymore, though, because he's frustrated at being less skilled than he once was.

Bach's drive brought him to Microsoft straight from business school at Stanford. Microsoft's Higgins was the first to interview Bach, meeting with him at Stanford. While Bach was intense, he wasn't abrasive. "You're always working *with* Robbie," says Higgins. "A lot of people you work *for*."

Bach's no pushover, though. One cru-

BIO



Robert J. Bach

President, Microsoft Entertainment & Devices Div., and Chief Xbox Officer

BORN: Dec. 31, 1961, in Peoria, Ill. Youngest of five, Robbie spent his childhood years in Milwaukee and in Winston-Salem, N.C. His father was a Schlitz Brewing exec.

TEEN YEARS: Suffered curvature of the spine, forcing him to wear a brace day and night for five years. Even so, he competed in tennis at the national level.

EDUCATION: BS in economics, University of North Carolina at Chapel Hill, 1984. MBA, Stanford University, 1988.

LANKY At 6'3", Bach was a teen tennis ace

CAREER: Worked for Microsoft in Europe, then was marketing manager for Microsoft Office in the mid-1990s. Has led the Xbox team since its inception in 2000 and was promoted to his current post, one of three presidents, in September.

FAMILY: Bach and his wife, Pauline, have three children, ages 15, 13, and 9.

HOBBIES: Plays basketball twice a week and works out two other days. He's a golfer with an 8.5 handicap. Rarely plays tennis anymore.

VIDEO GAMES: Admits he's not much of a gamer. If he's playing Xbox, it's typically a football game such as *Madden NFL*. He doesn't let his kids play during the week.

cial discussion for the Xbox team took place on Feb. 14, 2000, when they met with Ballmer and Chairman Bill Gates. Bach wanted the green light to develop the Xbox without using Windows. But Gates resisted, opening fire even before he sat down. "The operating system I've been working on for 25 years is not good enough?" Gates said, according to Xbox technology exec J Allard, also at the meeting. Bach held his ground, arguing that Windows would ruin the gameplaying experience because it wasn't specialized enough for the task. At the end of a three-hour meeting, Bach and his team had persuaded Gates and Ballmer to make one of the biggest financial bets in the company's history, using a completely foreign strategy. The event is known internally as the Valentine's Day Massacre, for how brutally it started. "None of us have ever forgotten that meeting," says Bach.

JUGGLING ACT

ONCE BACH GOT the support of his bosses, the next big challenge was winning over game makers. Bach planned on setting Xbox apart from PlayStation 2 by making the ability to play games online a core feature. But Xbox Live, Microsoft's online service, couldn't win the support of Electronic Arts Inc., the world's largest video game publisher. EA feared that Microsoft would horn in on its relationship with customers. Bach was willing to compromise. In the end, Microsoft agreed to share information on EA customers who consented to it. "Robbie was instrumental in our being able to come to an accommodation," says EA Chairman and Chief Executive Lawrence F. Probst III.

Bach won Gates's O.K. for an Xbox system that doesn't use Windows

Now, Bach is going the extra mile to win over developers for Xbox 360. One of the toughest decisions was launching the console at roughly the same time in all three major markets: North America, Europe, and Japan. It's a juggling act for Microsoft, but it gives developers more incentive to build great games and time them for release along with Xbox, since they know that they'll have a worldwide audience from the get-go.

Bach's approach to managing his own team is a bit unusual, too. He's no hung up on tapping Microsoft veteran In the Xbox group, he assembled a fou man brain trust—three of them fron video and entertainment. And he give each one latitude to run th technical, financial, an marketing pieces. "He le me call the plays. H lets me make mistakes, says Allard.

At the same time, h knows when to rein in hi team. Take the upcomin TV ads for Xbox 360. commercial consume won't see is a playful shoot out among people at a trai station, where all the peopl pretend to fire at others using their fin gers. In an era when terrorists target trai stations, Bach felt he had to quash the a in spite of its cinematic appeal. "It wa award-winning, unfortunately," he says.

For a guy who's constantly keepin score, passing on the ad wasn't easy. Bu Bach has succeeded by focusing on long term, not momentary, gains. That ap proach will come in handy as he tries t bring the Xbox touch to his new job. ■

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SPECIAL REPORT PHILANTHROPY 2005

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62 The devout donor: John Templeton
68 Which corporations are the most generous?
76 Big banks give back to the community

THE TOP GIVERS

For individuals, as well as corporate donors, the goal is to see results by "funding the solution, not the problem."

BY SUZANNE WOOLLEY

AMONG THE TECHNORATI, GORDON E. MOORE'S NAME IS LEGEND. THE INTEL CORP. CO-FOUNDER is the man behind one of the guiding principles of the tech industry—Moore's Law—which predicted, back in 1965, that the number of transistors that could fit onto a computer chip would double every 12 months (later revised to 24 months). As you'd imagine, his finances followed their own sort of Moore's Law, and the 76-year-old Californian's net worth is now $4.6 billion.

Forty years after Moore's famous equation, he and his wife are fast becoming legends in the field of philanthropy. In 2000, Moore donated half of his Intel stake to the Gordon and Betty Moore Foundation—worth about $5 billion—to fund mostly environment-related projects. And in 2005 the Moores achieved the unthinkable: They unseated Bill and Melinda Gates from their usual No. 1 perch on *BusinessWeek's* fourth annual list of the 50 Most Generous Philanthropists. (The Gateses, however, have given more over time.)

The Moores, like a growing number of big givers, take a businesslike approach to philanthropy. Rather than throwing money at problems, they try to ensure the most productive use of their dollars by funding projects they believe can produce "significant and measurable" results. This desire for accountability is one of the most important themes in this year's top 50 individual donors list. "We're beginning to see a much sharper focus on funding the solution, not the problem," notes Melissa Berman, CEO of Rockefeller Philanthropy Advisors. "Funding the problem is when people say, 'public education is a major problem, I have to do something, so I'll give money.' Fund-

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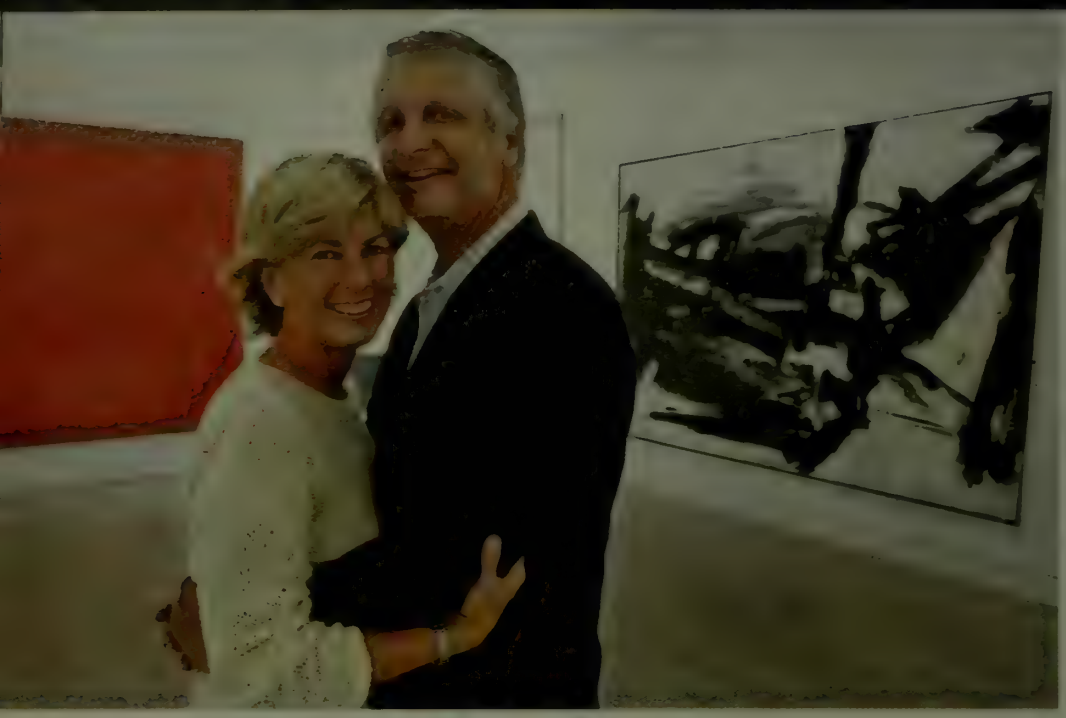
SUSANNA FROHMAN/SAN JOSE MERCURY NEWS



ART OF TEXAS Robert and Marguerite Hoffman's collection will go to the Dallas Museum of Art

ing the solution is talking to a lot of people, thinking it through, and deciding that small schools are the answer, or training great leaders to enter the public school system is the solution."

THE WEIGHT OF MEASURES

A STRONGER FOCUS ON RESULTS is also found among corporate givers (page 68). For more on the 200-plus companies that responded to our survey this year, visit BusinessWeek Online, where subscribers can explore our new interactive database for details on corporate giving programs (www.businessweek.com/go/philanthropy). And for a closer look at one person's controversial brand of philanthropy, take a look at our profile of billionaire John Marks Templeton (page 62), a man who is trying to reconcile science and religion (and is certainly not expecting any immediate measurable results). Templeton vaulted onto the list with a $550 million gift—the most dramatic move by any individual donor.

While Templeton has spiritual aims, the Moore Foundation is firmly rooted in the temporal world. "We feel fairly strongly that you have to measure if you're getting results or not, and that hasn't always been done rigorously in the foundation world," says Moore. To make sure the focus on results stays strong, Moore's son Kenneth, a semiconductor industry vet, is director of evaluation and information technology, in charge of measuring the effects of grants.

For a sense of how the foundation measures impact, look at how it tracks a 10-year, $145 million initiative to study the role of microorganisms in the ocean. They'll monitor the number of new organisms and genes discovered and the amount of new knowledge emerging about the functions of the microorganisms in journal articles and journal citations, which show if the research is useful to other scientists. Also, they'll track the number of multidisciplinary centers created and technology developed to further this kind of study.

Eli Broad, founder of SunAmerica and KB Home (and No. 9 on our list), is integrating business thinking into the world of giving in a different way. One program he and his wife fund takes top MBA students with a few years of experience and trains them for senior management positions in urban school systems. Another trains retired high-level military personnel, execs looking for second careers, and career educators to be school superintendents. Some 43% of the 63 graduates of Broad Superintendents Academy have been hired as superintendents or other high-level school positions, or been promoted into the jobs.

In the arts world, givers also worked to ensure that their gifts had impact. Robert and Marguerite Hoffman collaborated with other local collecting couples in designing their $170 million irrevocable bequest. The Hoffmans' collection, which includes works by Jasper Johns and Joseph Cornell, will go to the Dallas Museum of Art. Other big arts donors included David Rockefeller, grandson of Standard Oil Company founder John D. Rockefeller, who donated $100 million to the Museum of Modern Art, and W. Jerome Frautschi, the former Webcrafters vice-chairman, who gave $205 million for a new arts center in downtown Madison, Wis.

Another notable trend is that more givers turned to the big screen to spread their message. Founding eBay President Jeff Skoll helped fund three star-studded social-issue films (BW—Nov. 7). Ted Turner and Warren E. Buffett supported the nonprofit group Nuclear Threat Initiative, which produced *Last Best Chance*, a docudrama about nuclear terrorism. ■

–With Jessi Hempel and Bremen Leak in New York

METHODOLOGY

Where We Look And What We Count

Assigning a hard and fast dollar value to philanthropic gifts isn't nearly as straightforward as it sounds. Many donors work hard to keep gifts quiet, public information is incomplete, and gifts of stock can swing in value. So to compile *BusinessWeek*'s annual ranking, a team of reporters scours news reports, foundation filings, and online IRS filings, and conducts countless interviews. It takes months of work to compile our annual list of the 50 Most Generous Philanthropists.

As we've done every year since launching the survey in 2002, we rank givers by what they've pledged and given in the past five years. We count pledges because we think philanthropists who make legally binding promises deserve to be recognized. We also estimate lifetime contributions and present those figures as a percentage of a person's current net worth. For consistency, we count all pledges at the value at the time they were initially announced, discounting only those that have been formally revoked.

For more detailed information on our ranking methodology, please visit www.businessweek.com/go/philanthropy.

The 50 Most Generous Philanthropists

RANK NAME (DONORS NEW FROM LAST YEAR)	BACKGROUND	2001-2005 GIVEN OR PLEDGED MILLIONS	CAUSES	ESTIMATED LIFETIME GIVING* MILLIONS	REMAINING NET WORTH** MILLIONS	GIVING AS A % OF NET WORTH‡
1 **Gordon and Betty Moore**	Intel co-founder	7,046	Environment, science	7,300	4,600	159
2 **Bill and Melinda Gates**	Microsoft co-founder	5,458	Health, education, libraries	27,976	51,000	55
3 **Warren Buffett**	Berkshire Hathaway CEO	2,622	Reproductive choice, reducing nukes	2,730	40,000	7
4 **George Soros**	Investor	2,367	Open and democratic societies	5,401	7,200	75
5 **Eli and Edythe Broad**	SunAmerica, KB Home founder	1,475	Public education, arts, science	1,820	5,500	33
6 **James and Virginia Stowers**	American Century founder	1,205	Biomedical research	1,575	716	220
7 **Walton Family**	Family of Wal-Mart founder	1,100	Education	1,350	82,700	2
8 **Alfred Mann**	Medical devices	993	Biomedical education and research	1,500	2,100	71
9 **Michael and Susan Dell**	Dell founder	933	Children's health and education	1,230	18,000	7
10 **George Kaiser**	Oil and gas, banking, real estate	617	Antipoverty in Oklahoma	723	4,500	16
11 **John Templeton**	Investor	562	Spirituality and science	1,000	2,000	50
12 **Ruth Lilly**	Eli Lilly heiress	560	Poetry, libraries, culture, scholarships	760	210	362
13 **Michael Bloomberg**	Bloomberg founder, NYC mayor	528	Education, health care, arts and culture	733	5,100	14
14 **Veronica Atkins**	Widow of Dr. Robert Atkins	500	Eradication of obesity and diabetes	500	50	1,000
15 **Jeff Skoll**	Founding president of eBay	489	Social entrepreneurs	567	3,500	16
16 **Ted Turner**	CNN founder	457	Environment, global security	1,240	2,000	62
17 **Kirk Kerkorian**	Investor	453	Humanitarian and Armenian causes	687	10,000	7
18 **Donald Bren**	Real estate	447	Education, environment	457	5,700	8
19 **Pierre and Pam Omidyar**	eBay chairman, founder	433	Individual self-empowerment	523	10,200	5
20 **Patrick and Lore Harp McGovern**	IDG founder	370	Brain research	386	2,000	19
21 **Sidney Kimmel**	Jones Apparel chairman	352	Cancer research, arts, Jewish causes	495	750	66
22 **Irwin and Joan Jacobs**	Qualcomm co-founder	339	Education, arts	490	1,700	29
23 **Bernard Marcus**	Home Depot co-founder	311	Aquarium, Jewish causes, health	590	2,200	27
24 **Robert Meyerhoff**	Real estate developer	304	Art, higher education	305	NA	NA
25 **Paul Allen**	Microsoft co-founder	291	Arts, sci-tech, brain research	988	22,500	4
26 **Thomas Monaghan**	Domino's Pizza founder	284	Catholic education and services	451	500	90
27 **Larry Ellison**	Oracle CEO	267	Research on aging and diseases	690	17,000	4
28 **William and Claudia Coleman**	BEA Systems co-founder	254	Cognitive disabilities	254	75	339
29 **John Kluge**	Metromedia founder	241	Library of Congress, higher education	751	9,000	8
30 **Frank and Jane Batten**	Landmark Comm. founder	233	Higher education, childhood development	400	1,400	29
31 **David Rockefeller**	Standard Oil heir, banking	217	Higher education, conservation, arts	500	2,500	20
32 **Oprah Winfrey**	Harpo chairman	212	Education; women, children, and families	253	1,400	18
33 **David Geffen**	DreamWorks co-founder	208	HIV/AIDS, arts and culture, civil liberties	270	4,500	6
34 **Peter Lewis**	Progressive chairman	204	Education, arts, social reform	319	1,900	17
35 **David and Cheryl Duffield**	PeopleSoft co-founder	201	Animals, humane society, education	328	1,100	30
36 **Sidney Frank**	Sidney Frank Importing	200	Education, health care, arts	200	1,800	11
37 **Gary and Frances Comer**	Lands' End founder	190	Environment, education, youth	199	1,000	20
38 **William and Alice Goodwin**	AMF Bowling chairman	187	Cancer research, higher education	239	70	341
39 **Leo and Kay Drey**	Schram Glass heir, silviculture	180	Conservation	180	NA	NA
40 **Robert and Marguerite Hoffman**	Custom Food Group co-chairman	173	Dallas arts and social services, science	180	NA	NA
41 **Sandy and Joan Weill**	Citigroup chairman	171	Arts, education	315	1,400	23
42 **Jon Huntsman**	Huntsman founder, chairman	170	Cancer, business education, homeless	510	1,600	32
43 **Arthur Blank**	Home Depot co-founder	168	Youth, arts, environment, education	212	1,300	16
44 **Charles and Helen Schwab**	Charles Schwab chairman	167	Social issues, education, arts	232	3,800	6
45 **W. Jerome Frautschi**	Former Webcrafters vice-chairman	147	Arts	252	470	54
46 **Ira and Mary Lou Fulton**	Fulton Homes CEO	141	Education, community initiatives, cancer	160	425	38
47 **H.F. and Marguerite Lenfest**	Former Suburban Cable owner	138	Higher education, arts	381	825	46
48 **James Barksdale**	Netscape co-founder	135	Education and literacy in Mississippi	275	500	55
49 **Miller Family**	Family of Lennar founder	127	Higher education, medical research	127	143	88
50 **Bernard Gordon**	Analogic founder	120	Engineering education, medical research	125	125	100

*Based on public records and interviews with donors **Based on the Forbes 400 list and *BusinessWeek* estimates ‡Donations as a percentage of remaining net worth

Note: For a detailed explanation of our ranking methodology, go to businessweek.com/go/philanthropy

Data: *BusinessWeek*, GuideStar, *The Chronicle of Philanthropy*, Kintera PIN Electronic Screening

THE DEVOUT DONOR

John Templeton's $550 million gift doubles his funding of research aimed at showing that science and religion needn't be at odds

BY JESSI HEMPEL

SIR JOHN MARKS TEMPLETON HAS BEEN A CONTRARIAN FROM the start. In 1939, when he still lived in a grungy Manhattan walkup with mismatched furniture, Templeton borrowed $10,000 and used it to buy $100 worth of every stock valued at less than a dollar on the New York exchange. The timing hardly seemed opportune: Hitler had just invaded Poland. But Templeton believed that the impending world war would drive up the market—and he was right. He went on to become one of Wall Street's most successful celebrity stockpickers and then to pioneer the first global-investing mutual funds, ultimately selling his Templeton family of funds to Franklin Resources for $913 million in 1992. His stake: about $440 million.

Now 92 and comfortably ensconced at a Bahamas estate, Templeton has recently made what may be his boldest move yet. Last December he donated $550 million to his already existing private foundation, propelling himself to No. 11 on this year's list of *BusinessWeek*'s 50 Most Generous Philanthropists. His was no ordinary gift. While the vast majority of America's philanthropic heavyweights choose to address traditional and tangible social needs—feeding the hungry, curing the sick, subsidizing the arts—Templeton has something else in mind. He wants to make an impact on the world of ideas.

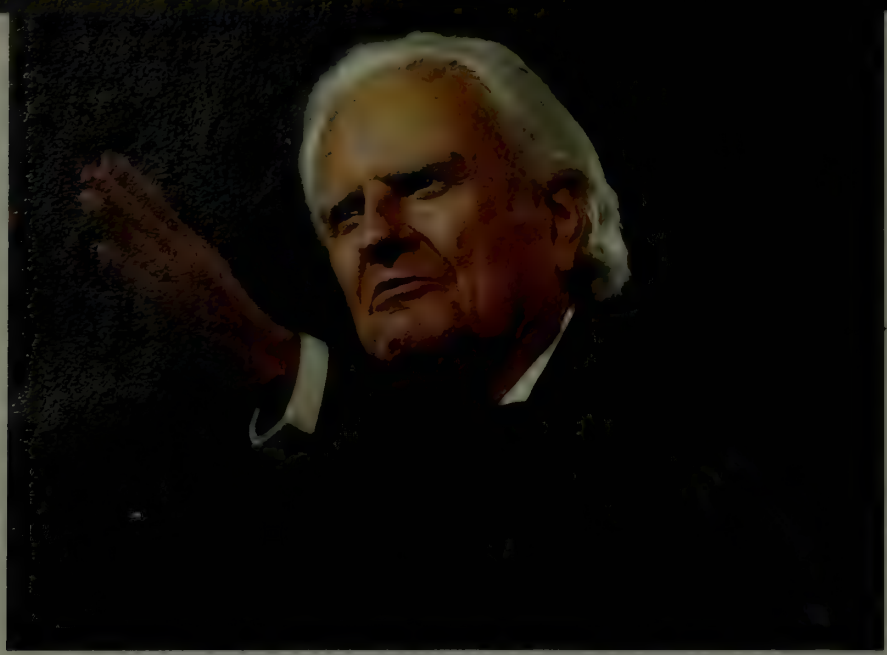
Templeton's controversial goal: to reconcile the worlds of science and religion. A devout man, Templeton began each morning at his mutual fund group with a companywide prayer. Yet he is also a creature of Wall Street—analytical, numbers-driven, and skeptical. When he hears scientists quarrel with believers, he thinks both sides are missing the broader point. "What I'm trying to do is say: 'Don't try to argue—maybe you're both right,'" says the energetic billionaire, who still drives his tan four-door Kia Opirus two miles to his office five days a week.

What projects are being subsidized with the $60 million the John Templeton Foundation now hands out every year? It's a unique mix of science and faith, traditional research and provocative speculation. One beneficiary is a Duke University professor who is investigating the impact that regular church attendance has on blood pressure. Another is the Christian liberal arts institution Calvin College, which puts on Templeton-sponsored seminars with titles such as "Evolutionary Psychology and Scripture Scholarship: More Similar Than You Might Have Thought." The $1.5 million Templeton Prize for Progress Toward Research or Discoveries about Spiritual Realities has been given to everyone from Mother Teresa to physicist Freeman J. Dyson to Watergate-felon-turned-evangelist Charles W. Colson to evangelist Billy Graham.

SEEKING A DIALOGUE

TEMPLETON'S VENTURE IS THE MOST quixotic mission being undertaken by any major American philanthropist. He is, of course, far from the only person in the country interested in reevaluating the relationship between religion and science. Social conservatives are challenging orthodoxies such as Darwinism and the Big Bang while fighting for their right to control what is

AT HOME IN THE BAHAMAS Templeton is moving religion into academia



BILLY GRAHAM The evangelist received a Templeton prize worth $1.5 million

taught to schoolchildren. Templeton has done much to cheer their hearts. The Association of American Medical Colleges, for example, credits his foundation for the course in spirituality and medicine that has become a standard part of the curriculum in more than two-thirds of the country's medical schools over the past decade.

But it would be a mistake to pigeonhole Templeton as a member of the Religious Right. While the foundation in the 1990s backed supporters of the theory of intelligent design, the notion that God had a hand in creation, it has since distanced itself from the idea. Foundation Vice-President Charles L. Harper says the group is the largest funder of projects challenging intelligent design and notes that it has invited scientific critics such as Harvard chemist George M. Whitesides to speak at conferences. "We're not trying to encourage people to jump on one side of the fence and throw mudballs at the other," says Harper. "We're in favor of dialogue."

The Templeton Foundation is clearly walking a fine line, but it's one that feels comfortable to its founder. Templeton's own faith stems from a Winchester (Tenn.) childhood in which his parents pushed Christian values of thrift and compassion. "I grew up as a Presbyterian," he says. "Presbyterians thought the Methodists were wrong. The Catholics thought all Protestants were wrong. The Jews thought the Christians were wrong. So what I'm financing is humil ity. I want people to realiz that you shouldn't thin you know it all."

A visit to Templeton' boxlike home in the well-heeled Bahamian neigh borhood of Lyford Cay makes it clear he is focuse on more than material things. Paint flakes off th antebellum pillars outside the Plantation-style res idence. Inside, many of the kitchen's original 196 appliances grace formica countertops. Frenc doors open from the living room onto a brick ve randa, offering views of a posh seaside golf club.

Templeton doesn't get to the nearby beach to much anymore. But he still has perfect posture, a affable grin, and the hint of a gentleman's South ern drawl. A naturalized British citizen, he wa knighted by the Queen of England in 1987 for hi charity. Yet at the tiny third-floor office of his foun dation, he does his own photocopying and some times answers his own phone. From the comfort of an office recliner upholstered in a print of butterflies, he reviews foundation proposals, flagging promising philanthropic investments in faxes he sends daily to foundation headquarters in Conshohocken, Pa. On a recent Monday he sent six.

HANDING OVER THE REINS

THE PERSON ON THE RECEIVING END of those faxes is usually Templeton's son, foundation President John Templeton Jr., a former trauma surgeon and a born-again Christian. He has been on a hiring tear. In the wake of his father's enormous gift, he must quickly figure out how to more than double the number of grants the foundation makes.

To see how the foundation operates, consider how it moved spirituality onto medical school curricula. In 1992, when Dr. Christina Puchalski taught her first course on spirituality and healing at George Washington University, she knew of three other medical schools offering such courses. In 1995 the Templeton Foundation began offering prizes (now $50,000 for medical schools) to the programs that best integrate issues of spirituality and medicine into their offerings. A few years later the foundation sponsored a conference where professors agreed on a standardized curriculum for a course that teaches medical

A Templeton Grant Sampler

The financial legend gives money to a broad mix of scientists and priests, psychiatrists and social workers. Sometimes recipients have competing ideas. Occasionally they even work at cross-purposes.

RELIGION

Templeton's foundation sponsors an annual conference, Evolutionary Explanation, Biological Function, and Divine Purpose, held at Calvin College, a Christian liberal arts institution. Among 2005's seminar topics: "Why Would Anyone Believe in God? An Introduction to the Cognitive Science of Religion."

SOCIETY

Some 15% of the Templeton Foundation's grantmaking is devoted to issues other than the relationship between science and religion. In one of these projects, a professor at the University of Newcastle is studying how poor students benefit from private schools in Asia and Africa.

COSMOLOGY

A 1999 prize competition offered grants to scientists asking: Is there evidence of a universal purpose in the cosmos? Recipients included University of Washington astronomer Guillermo Gonzalez. He later joined Discovery Institute, the major proponent of the theory of intelligent design.

PSYCHOLOGY

Templeton's Institute for Research on Unlimited Love is funding a California psychiatrist who is looking into the protective effects of love on how U.S. military veterans adjust to combat trauma. Another project involves an Emory University researcher who is measuring empathy in chimpanzees.

You use 25 barrels of oil a year.

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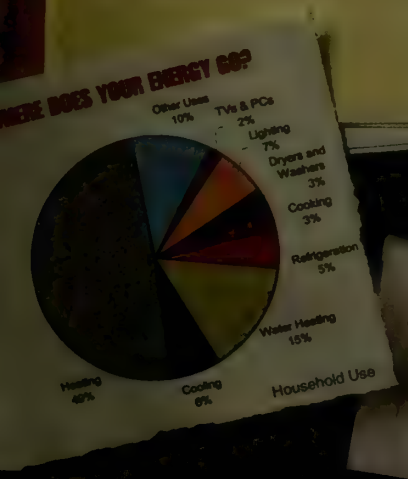
Because of surging economies in the developing world and continued growth among the industrialized nations, global energy use is soaring. As a result, supplies are tight. Prices are rising. And energy users are calling for viable alternatives.

The good news is we've got a huge source of alternative energy all around us. It's called conservation, and it's the lowest cost new source of energy we have at hand. Since 1973 alone, improvements in energy efficiency have resulted in a 50% reduction of our daily energy use, which is the same as discovering 25 extra million barrels of oil equivalent every single day. Clearly, saving energy is like finding it. But we all need to do more.

For developed and emerging economies alike, incorporating energy efficient technology into construction projects can reduce consumption by 40%. The use of more fuel efficient vehicles – including hybrids – is encouraging, and if automakers improved fuel economy across the board by just 5 mpg, we'd save over 22 billion gallons of gasoline a year. Governments and businesses need to reduce their own energy use and promote conservation to their citizens and employees. And the average person wields incredible power when it comes to conserving energy; if everyone lowered their heating temperature 6 degrees, we'd save 570,000 barrels of oil every day.

Of course, not only does using less energy mean there's more fuel to go around, it also means fewer greenhouse gas emissions. The fact is, if everyone began conserving today, we'd see results immediately. We've taken some of the steps needed to get started, but we need your help to get the rest of the way.



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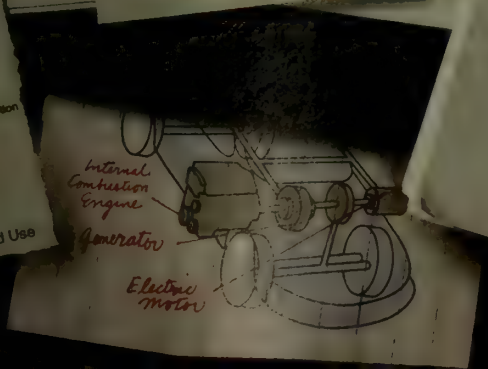

Conservation Facts:

The U.S. consumes a million dollars worth of energy every minute

•

Replacing just one incandescent lightbulb with a compact fluorescent lamp would save 500 pounds of coal and over a 1/2 ton of CO_2 emissions

•

If just one in 10 homes used ENERGY STAR®-qualified appliances, the environmental benefit would be like planting 1.7 million new acres of trees

Chevron Steps Taken:

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- Since 1992, Chevron has reduced its own energy consumption by 24%
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Saving other people's energy:

Chevron has a separate, proven business dedicated to energy efficiency. Success stories include:

- Improvements that will lower the Northern CA postal service's electricity spending by 46%
- Helping the U.S. government save taxpayers $151 million while reducing greenhouse gas emissions by an expected 1.5 million tons

Chevron

Human energy™

NIGERIA One project studies the effects of private schooling on poor children

students about the role of clergy and helps them understand their patients' religious backgrounds.

The funding, paired with an official curriculum, has led about 90 of 125 medical schools to adopt similar programs. "When educators can say I've got money, I've got this outside institution backing me up, they're much more likely to be met with support," says Brownell Anderson, senior associate vice-president for medical education at the AAMC, who credits the Templeton Foundation for the spike.

SIMPLISTIC vs. SOPHISTICATED

TEMPLETON HAS ALSO LENT credibility to research on the topic of forgiveness. The National Institutes of Health didn't fund any projects related to the subject until 1999, when it backed Virginia Commonwealth University psychology professor Everett L. Worthington Jr.'s study *Forgiveness, Humility, and Gratitude Among Recently Married Couples*, which measured how an education program on forgiveness and reconciliation affects newlywed couples. Worthington's project was also funded by the Templeton Foundation. This year the NIH funded five projects relating to forgiveness. Worthington says that before 1997, when the Templeton Foundation first began funding research on the subject, he could find only 50 studies even remotely related to forgiveness. At last count the number of scientific-paper citations had climbed to nearly 4,500.

By increasing references to religious concepts in scientific journals and by moving religion into public discussion at universities, Templeton has made it easier for closeted believers within the elite halls of the Ivy League to form communities. Martin A. Nowak directs the Program for Evolutionary Dynamics at Harvard University, where he spends his time trying to figure out why people have evolved to help each other if evolution simultaneously fosters competition. Nowak is also a practicing Roman Catholic, a fact he has kept quiet at Harvard until recently. He says the climate is changing on his campus. "As a scientist who believes, you feel you are completely in the minority and you should never talk about it," says Nowak, who recently became an adviser to the Templeton Foundation. "It's nice to meet people with whom you can talk about a mor complete perspective of the world."

Critics worry that Templeton i buying the support of scientists wh are desperate to win research dollar Sean Carroll is an assistant professo of physics at the University of Chica go. An outspoken atheist, he recentl declined an invitation to present at Templeton conference at the Univer sity of California at Berkeley. He say that because funding for quantum mechanics is hard to get, some of hi colleagues are willing to take Temple ton's research grants even if they don' support his beliefs. The Templeto folks make it tempting, he says, be cause unlike other academic confer ences, Templeton's confabs pay pre senters. Carroll says he would hav received $2,000 to speak at the con ference, a similar sum if he publishe his talk in their anthology, and chance at a $10,000 prize for scien tists under 40. For an impoverishe academic trying to scrape by, that's al luring. Says Carroll: "That's money could have used to, say, buy a car!"

Other atheists take a more neutra stance. In 2003, Harvard chemis Whitesides agreed to help the Templeton Foundation organiz a cosmology conference called "Biochemistry and Fine-Tuning." Whitesides says he was surprised by the extent to which spirituality was downplayed at the conference. Says Whitesides "There are simplistic views and then there are more sophisticated views, and I think the Templeton Foundation embraces sophisticated view."

The foundation will have new leadership soon, though. At the time he made his gift, Templeton announced that he'll step down in January, leaving his son, a conservative philanthropist whose religious views are more traditional than his father's, to chair the board. Templeton has designed a process to keep his grantmaking on track: Every five years independent analysts will evaluate whether officers are making grants that match his intent. If they find his son is giving 9% of the grants to other causes, John Jr. has one year to correct the problem. If not, he'll be fired along with his two top people. That's not very forgiving, but it's one way to ensure that Templeton's unique vision lives on. ■

Follow the Money

Intelligent Dilemma: The Templeton Foundation's Charles Harper explains why the faith-friendly nonprofit takes issue with intelligent design

Comparing Corporate Givers: Use our new database to see how companies stack up—on both cash and in-kind gifts

The Stories Behind the Gifts: To hear interviews with top givers, including Gordon Moore and David Rockefeller, check out *BusinessWeek*'s podcast series on the most generous philanthropists

BusinessWeek online

www.businessweek.com/go/philanthropy

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SMARTER CORPORATE GIVING

LINCOLN CENTER Support for the arts has boosted Altria's reputation

Targeted donations, support for volunteers, and consumer awareness ads are paying off

BY NANETTE BYRNES

ON NOV. 9, WITH THE LIGHTS OF AVERY FISHER HALL TWINKLING overhead and black-clad waiters weaving about bearing trays of champagne, New York's philanthropic A-list gathered at Lincoln Center for the Performing Arts to toast one of their own. No, the applause was not for a Rockefeller or a Hearst or a Soros. It was for Altria Group Inc., parent to the maker of Marlboro cigarettes—a company that, in many circles, wears a corporate black hat. But in the world of philanthropy Altria is viewed very differently—as an old friend and treasured supporter.

It's not just dance troupes and opera companies that sing the company's praises. Altria, which also owns Kraft Foods Inc., has spent more than $1 billion in cash and in-kind gifts over the past decade to combat domestic abuse, feed the ill and elderly, and respond to disasters such as Hurricane Katrina. Altria's 2004 cash gifts totaled $113 million, earning it third place in *BusinessWeek*'s ranking of corporate givers.

Such contributions will never be enough to overcome the issues inherent in making a lethal product. But over the years, through consistent philanthropy and careful responses to grassroots needs, Altria has managed to build a deep reservoir of goodwill in charitable circles. Eight or nine years ago, Altria Vice-President for Contributions Jennifer P. Goodale says she couldn't attend a press conference without fielding questions about Altria's ulterior motives. Today that's rare. The rebound of the company's reputation is the result of many things. Altria's once-towering legal and political challenges have begun to look less daunting, and shareholders are sweet on the stock, which is up 38% in the past 12 months. But as the event at Avery Fisher Hall shows, generous giving has been a major aid in turning the corporation's image around. Lincoln Center's chief fund-raiser, Tamar C. Podell, has only good things to say about the company. "They have stood with us, supporting

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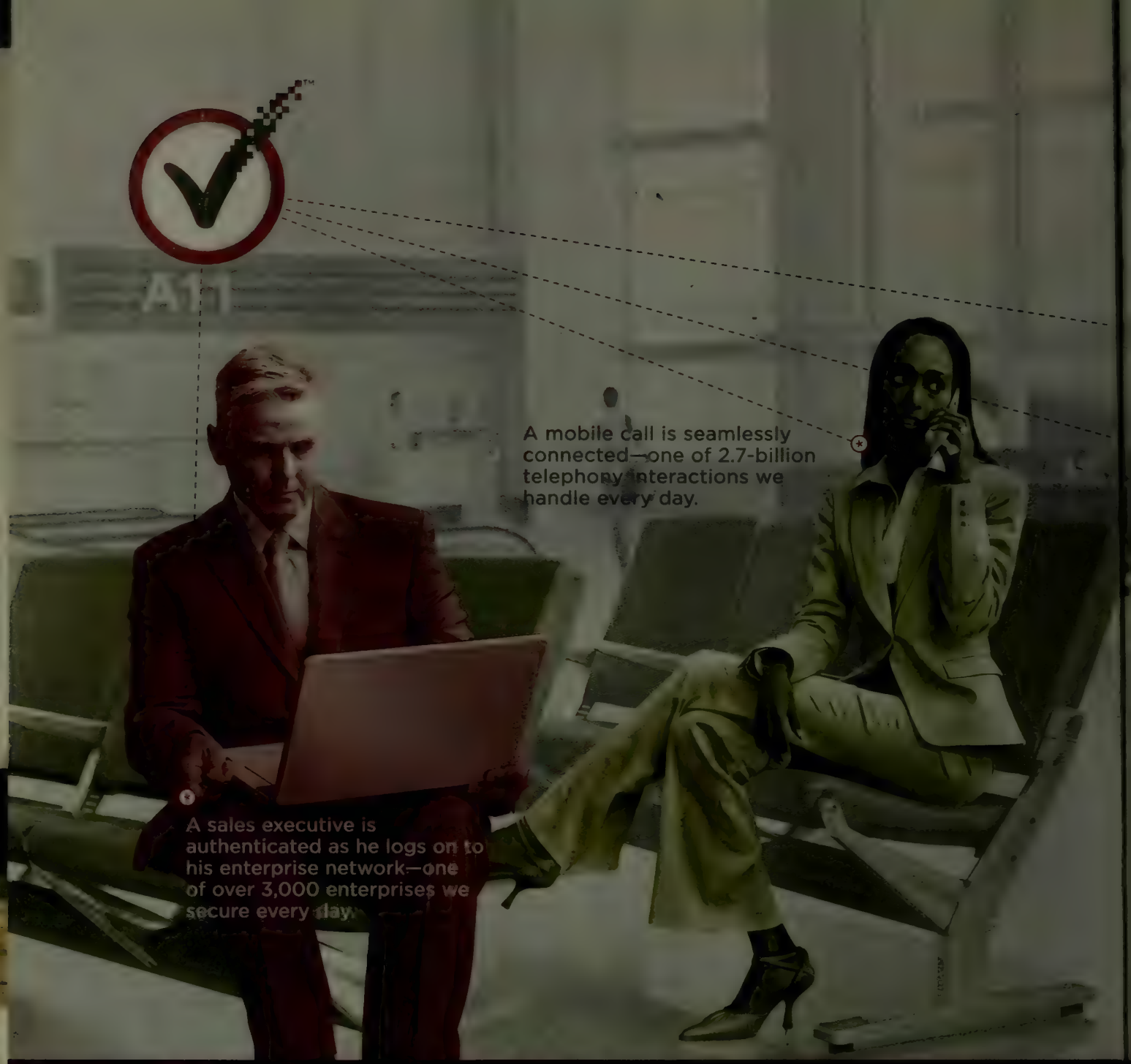

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Big Kahunas, but...

These companies make the largest cash donations. When their gifts are looked at as a percentage of pretax profits, however, many of them drop in the ranking of most generous corporate givers.

COMPANY	2004 DONATIONS* (MILLIONS)	COMPANY	2004 DONATIONS* (MILLIONS)
Wal-Mart Stores	$188.0	Bank of America	$108.0
Johnson & Johnson	121.8	Target	107.8
Altria Group	113.4	ExxonMobil	106.5
Citigroup	111.3	Wells Fargo	93.0
Ford Motor	109.8	Wachovia	81.7

*Fiscal year

Data: Company reports

a huge range of arts, and took major risks," she says.

Altria executives grasped the power of a form of enlightened self-interest earlier than many of their peers. Although companies are not handing out much more on the whole—last year's giving equaled 1.2% of total corporate profits, the average over the past 40 years, according to the Giving USA Foundation—they are taking a more businesslike approach to charity. The goal: to get the most out of every philanthropic dollar by tracking giving, measuring its impact, and helping nonprofits work more efficiently. Today companies such as Altria see giving as a way to please customers, motivate workers, and be a good corporate citizen at the same time. "Businesses succeed because they're results-oriented," says Steve Rochlin, director of research and policy development at the Center for Corporate Citizenship at Boston College, which is trying to create a tangible measure of philanthropic effectiveness. "It's a waste of resources for the community and companies not to get more rigorous about the kind of results they want to achieve."

Like many heavyweight cash givers, Altria is making a repeat appearance this year. Eight of the 10 biggest corporate donors in this year's list were there last year, too, including Wal-Mart Stores Inc., which gave $188 million this year and kept the No. 1 slot. The two newcomers to the list are Target Corp. ($107.8 million) and Wachovia Corp. ($81.7 million). It's easier for the big guys to give big, of course, so to figure out who's really making a sacrifice, *BusinessWeek* also compared giving (both cash and in-kind) with pretax corporate profits. This is a change from last year, when we looked at those gifts as a percentage of revenue. We think the change sheds a clearer light on who's really digging deep. Of the mega-companies, only Target survives this cut, giving out cash equal to an impressive 3.6% of pretax profits. Those who handed over the largest slice of profits to charity in cash include retailers, grocers, and tech companies. Drug manufacturers dominate the list of in-kind givers.

Companies boast about this good work for good reason. At a time when corporate behavior is scrutinized by everyone from consumer bloggers to Sarbanes-Oxley-empowered regulators, philanthropic goodwill is a highly prized commodity. A KPMG International study published in June found that 52% of the world's 250 largest corporations filed separate reports on corporate responsibility in 2005. That's up from 45% in 2002. Target, Wal-Mart, and many other companies have funded national ad campaigns promoting their good works. In the October issue of *In Style* magazine, branding expert Carol Cone counted more than 25 "cause" ads, the vast majority of which were companies heralding their support of breast cancer research and prevention.

CONSUMER AWARENESS

THE PUSH SEEMS TO BE working. In 1993, Cone found 26% of the people she surveyed could name a company that stood out as a strong corporate citizen. By 2004, 80% could. "Philan-

What Kind of Gifts?

Some corporations prefer to donate cold, hard cash. Others make all or part of their contributions as in-kind gifts of goods and services. We ranked the most generous givers by calculating cash and in-kind donations as a share of pretax profits.

Most generous cash givers

COMPANY	2004* CASH GIVING (MILLIONS)	GIFTS AS A % OF PRETAX PROFITS
Computer Associates	$12.0	108.9%**
Biogen IDEC	8.3	13.0
Kroger	35.5	12.2
Tiffany	26.0	5.5
Advanced Micro Devices	4.2	5.4
ADC Telecommunications	1.7	5.1
Supervalu	25.0	4.2
Freeport-McMoRan	21.6	3.8
Eastman Chemical	2.4	3.7
Target	107.8	3.6
General Mills	60.3	3.2‡
Safeway	25.0	3.2‡
General Motors	51.2	2.7‡
Hilton Hotels	10.0	2.7‡
Genzyme	5.5	2.5

Most generous in-kind givers

COMPANY	2004* IN-KIND GIVING (MILLIONS)	GIFTS AS A % OF PRETAX PROFITS
Biogen IDEC	$65.0	101.4%
Parametric Technology	17.8	48.1
HCA	926.0	43.3
Halliburton	227.1	34.9
Genzyme	46.2	20.8
Kroger	59.8	20.6
Bristol-Myers Squibb	601.9	13.6
Safeway	100.0	12.6
Lilly	338.0	11.5
Merck	921.0	11.3
Computer Associates	1.0	8.9
Pfizer	1161.9	8.3
Abbott Laboratories	270.0	6.5
Yum! Brands	54.0	5.3
Office Depot	24.0	5.2

*Fiscal year **Computer Associates' large percentage is the result of sharply reduced profits at a time when company giving fell only slightly
‡ Article broken in decimals

Data: Company reports

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CINCINNATI Kroger donates to food banks via Second Harvest

thropy before was quiet," says Cone. "Now, if you're doing it with authenticity and credibility, you can tell people about it."

A company sets itself up for a higher level of scrutiny overall when it crows about its good works, however. Home Depot Inc. is well known as a big supporter of employee volunteerism and projects such as its recent vow to build and refurbish 1,000 playgrounds in 1,000 days, much of which it and its partners publicize in press releases. But CEO Robert Nardelli found his company's giving the subject of two unfavorable stories in his hometown paper, the *Atlanta Journal-Constitution*, on Oct. 16. When translating giving as a percent of profits, the paper found Home Depot to be a low cash giver relative to other local employers. Nardelli defends his employees' good works and shot off an e-mail to employees in response, with a three-page addendum outlining their volunteerism and the company's good works. "I don't do it for the PR," says Nardelli.

The best defense against all such criticism is to build a true business case for giving. It isn't always easy, but the best companies are constantly working to develop metrics that prove the value of their gifts. Altria, which on its Web site lists all of the 464 initiatives it supported in 2004 and the size of its gifts, doles out a lot of unrestricted money to a wide variety of causes. That has made it particularly hard to create a single measure that proves its gifts to institutions are working. Traditionally, Altria has relied on site visits and testimonials to assess its work. The company also recently launched a program with Rensselaerville Institute, a think tank near Albany, N.Y., to try to help nonprofits better measure and communicate their impact. And the company's giving is reviewed at the very top. Once or twice a year, Altria CEO Louis Camilleri meets with the giving staff to discuss their work, and he personally approves any gift above $50,000.

More directed giving is easier to track. General Mills Inc. kept close track of how its pink-topped Yoplait yogurt sold this past October. Customers who sent the tops in to the company earned a 10¢ gift to the Susan G. Komen Breast Cancer Foundation. Sales were healthy, says Chris Shea, president of the General Mills Foundation. At Kroger Co. supermarkets, the major form of corporate philanthropy—aside from product donations to food banks—is the discount gift-card program. Hundreds of thousands of local nonprofits, from Boy Scout troops to PTAs, buy cards at 95% of the face value to resell at 100%. They get to keep the difference. Last year, $460 million in cards were sold. In addition to shoppers spending that money at the stores, Kroger also got a $23 million tax write-off for the 5% discount it gave on the cards.

SUPPORTING VOLUNTEERS

INCREASINGLY, COMPANIES ARE LOOKING beyond customers to their own employees for a philanthropic payoff. Businesses from Wachovia Bank to General Mills say low employee turnover is one of the benefits of their philanthropic focus. More companies are trying harder to track their workforce volunteers. AngelPoints in Sausalito, Calif., which sells a program that helps companies track employee volunteering, has added 60 clients in the past four years, mostly blue chips. And more companies are using employee volunteer interests as a means of directing their giving. Hilton Hotels Corp. donates $300 to any

METHODOLOGY

How We Tallied Corporate Largesse

To create this year's rankings of corporate givers, *BusinessWeek* invited companies in the Standard & Poor's 500-stock index to report on their 2004 giving. We heard from 204 companies, or 41%. Of those, 190 reported numbers reflecting their cash gifts; 140 provided values for in-kind gifts such as products and services.

We changed the way we calculate rankings this year. In the past we used the numbers reported by companies to create ratios of giving as a percentage of fiscal year revenues, as measured by S&P. This year we switched to a ranking method the philanthropic community considers more accurate. Now we are presenting corporate giving as a percentage of fiscal year 2004 company pretax profits. We used these percentages to tally our rankings of the top 15 cash and in-kind givers.

We try hard not to count donations twice. Since many companies make charitable donations through corporate foundations, we chalk up donations only when they are made to the foundation—not when the foundation makes grants. We hope our rankings offer insight into how companies go about the business of philanthropy.

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group to which an employee volunteers 50 hours a year. And the company's volunteer of the year can send $5,000 to a favorite charity. Wachovia gives six paid days off for volunteer work a year and $100 to any nonprofit where an employee spends 25 hours in a year. Hilton even determines a percentage of executive bonuses based on time spent volunteering in the community.

One downside for charities is that as companies become more focused on measuring the results of giving, they're less willing to give unencumbered funding that helps pay ordinary operating expenses. But that may force charities to become smarter about measuring their impact. Lincoln Center, which is in the midst of a building-expansion drive, commissioned a study of its economic role in the community in October, 2004. Included in the 41-page analysis: Its local real estate appreciated 2,161% more than the Manhattan average, a difference equal to $2.2 billion. Lincoln Center also hit up Altria for $60,000 to make a fund-raising film about the center this year. The company that built Marlboro into a giant brand knows the value of good marketing—for philanthropies and businesses. ■

FINANCIAL SERVICES

Banking on Communities

In November, Asian Americans for Equality (AAFE) got a big boost from Bank of America—a $200,000 unrestricted grant. The 80-person nonprofit helps immigrants find affordable housing by providing financial education and guidance through the maze of government programs and bank rules. The group, which was launched in 1974 to focus on the needs of immigrants in Manhattan's Chinatown, now works throughout New York City's five boroughs.

As part of the grant, Executive Director Christopher Kui got to participate in the bank's management-training programs. What did BofA get out of the deal? Kui sees himself as a bridge to the immigrant community, which makes up 10% of the U.S. population, and to an important segment of the larger "multicultural" market that many banks increasingly court. A third of AAFE's clientele is now non-Asian, including the family of Jorge and Marta Morales, originally from Ecuador and now living in Ozone Park, Queens. The couple and their 16-year-old daughter, Leonela, had rented an apartment for 15 years in the small building that AAFE recently helped them buy.

Bank of America's efforts are typical of big banks, which are once again big givers in *BusinessWeek*'s ranking of corporate philanthropists. Of the top 10 cash givers on this year's list, four are banks: Citigroup, Bank of America, Wells Fargo, and Wachovia. Their giving has roots in the Community Reinvestment Act of 1977, which was meant to encourage banks to help meet the credit needs of the low- and moderate-income neighborhoods in which they do business. Banks get bonus points for community good works on the grading of their compliance with the Act—but that giving has also become an important way to stay close to customers as the ever-merging, ever-larger institutions try to maintain local loyalties.

Because all four of these banks have strong consumer businesses, with more than 13,000 branches among them, they give locally as much as possible. Wells Fargo, for example, leaves the decision-making to its 60 regional contribution directors, with headquarters giving guidance and twice a year coordinating a national conference but otherwise stepping back. Wachovia has a similar grassroots focus. "The community needs to decide what they need help with," says Frank Addison, Wachovia's director for corporate philanthropy. At Bank of America, which made more than 3,000 grants in 2004, the decision about where money goes is made by managers at the local level. In Miami education is the top priority, with affordable housing and multicultural issues ranking second and third. But across the state in Indian River, Fla., arts and culture are the primary focus.

THE MORALES FAMILY Bank of America funds a nonprofit that helped them buy a building

U.S. banks, which employ more than 2 million people, are increasingly using these employees to help direct their philanthropy and put it into action. Since Wells Fargo launched its financial-literacy program early last year, the San Francisco-based bank has trained 5,000 staffers to teach the program in schools and community centers. It's available in English and Spanish, for individuals on the Internet, via DVD, or on paper. Wells Fargo has sent packets as far away as China, Brazil, and India. That the bank has expertise in this area is to be expected. Less expected is that there are no ads trumpeting its efforts, even on the program's Web site, which, since January, 2004, has had more than 11 million visitors viewing an average of 112 pages per visit.

That's not to say banks aren't promoting their good works. It was important to Bank of America to paint itself as a good corporate citizen after it bought Fleet Bank, a longtime New England institution, in October, 2003. Managers immediately promised to put more than $100 million into New England charities from 2005 to 2010. Even though the bank has cut 17,000 jobs since the deal was inked, customers rate the bank more favorably than the old Fleet. It has gained more than 400,000 new checking and savings accounts and has seen a 20% rise in commercial loans. "It may be partly because of the [better] economy, but you would not have seen that kind of a trend if it felt like an abandoned market," says Anne M. Finucane, BofA's president for the Northeast. It's hard to find a set of numbers that would please a banker more.

–By Nanette Byrnes in New York

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ANALYTICS THE MULTI-TASKING MAGICIAN

Companies today are using analytics to plan shipping routes, personnel hires and pricing. It seems there is nothing analytics can't do.

Don't tell Jay Bowden that moving cargo off ships seems like a straightforward job. As vice president of financial planning and analysis at Marine Terminals Corp., Bowden knows the boggling array of interlinked factors that can dramatically affect freight-handling costs at ports. What impact will changing ship schedules have on production? What mix of workers and equipment will be needed based on expected cargo volumes? How will changes in the complicated labor contracts affect future costs?

In the past, the answers to these questions were often locked in separate databases that didn't talk to one another or lost in Excel spreadsheets on someone's desk. "The cumbersome legacy systems wouldn't allow us to analyze our operations or run what-if scenarios to help us decide what resources we were going to need," Bowden says. "We knew what had happened in the past, but it was difficult to predict what would happen."

That's changed, thanks to an analytics system that gives executives a clear view into key metrics. As a result, Marine Terminal has significantly boosted productivity and improved the per-unit handling cost of containers, cars, refrigerated products and other goods.

Such results are not unusual: A study

by market research and consulting firm International Data Corp. (IDC) showed that the average return on business analytics projects was almost four-and-a-half times the initial investment. And given those results, it's not surprising that the term analytics has moved quickly from IT circles to executive suites or that analytics software is now driving the $15 billion business intelligence (BI) market, according to IDC.

Though stories abound of how companies have used sophisticated analytics software to discover insights about operations, financial performance, marketing campaigns and product success, experts say users remain confused about analytics.

"There is a lack of understanding about analytics," says Wayne Eckerson, director of research and services at The Data Warehousing Institute. "Many people don't have a conception about this technology or how it can be applied to their business."

Two Types: Many Uses

The field of analytics can be divided numerous ways. Some people differentiate between analytics that are designed to analyze the behavior of human beings and physical systems, like manufacturing lines. Others carve up the analytics space by function—financial systems, supply chains, customer relationship management and the like.

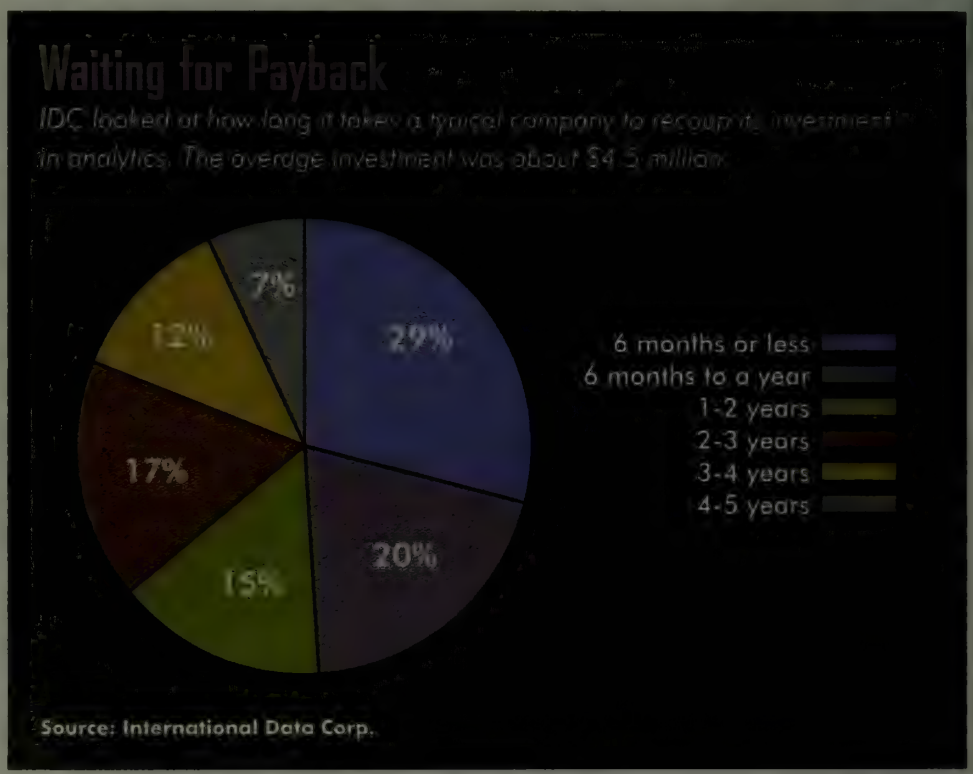
Dan Vesset, research director for analytics and data warehousing at IDC, divides analytics into two classes:

Core analytics. These tools and applications put better metrics in front of a user. They are used to define or analyze a current or past state. They include query, reporting and analysis, packaged data marts and analytic applications using these functions or technologies.

Predictive analytics. More mathematically complex than core analytics, predictive analytics are used to determine the probable future outcome of an event. Statisticians would break this category down into things like data mining, clustering, decision trees, market basket analysis, regression modeling, neural nets, genetic algorithms, text mining, hypothesis testing and decision analytics.

Roman Bukary, vice president of composite and analytic solutions marketing for SAP, notes that analytics need to become "part and parcel of almost every business application." Take, for example, a business trip, the most basic and common business transaction. If Bukary were to book a business trip using a composite application, analytic capabilities of that application would notify him as to how much of his travel budget he's consumed, when it will be used up at the current rate, potentially propose alternative travel options and, if necessary, kick off a new process to obtain additional budget approval. "Because of this, I can start to think if I really need to make the trip or if I should be teleconferencing," he says. "In that case, analytics is integrated into the business process of what I was doing without my being aware of it, making me and the overall business process smarter, more efficient and, ultimately, more intelligent."

Experts say analytics should start by identifying the business pain point and deciding what information users need to make an informed decision. "A lot of people have the stereotyped view that analytics involves backroom coders in white coats using regression models and decision trees," says Farhana Alarakhiya, director of global market development in the performance analytics business unit at Cognos. "But you don't need to apply a neural net for the vice president of sales to see whether the company is on track in meeting objectives—simply getting visibility into the data might be enough."



Why the Confusion?

Given the impressive ROI numbers as well as the increasing use of analytics, why does it remain confusing to some? Experts say it's partly because companies often don't realize that analytics can improve such a broad range of tasks, from business processes and new product introductions to optimized marketing campaigns and supplier negotiations. Also, the more advanced forms of analytics grew out of data mining, which was never well-defined.

Analytics isn't simply about building the best statistical model to analyze a

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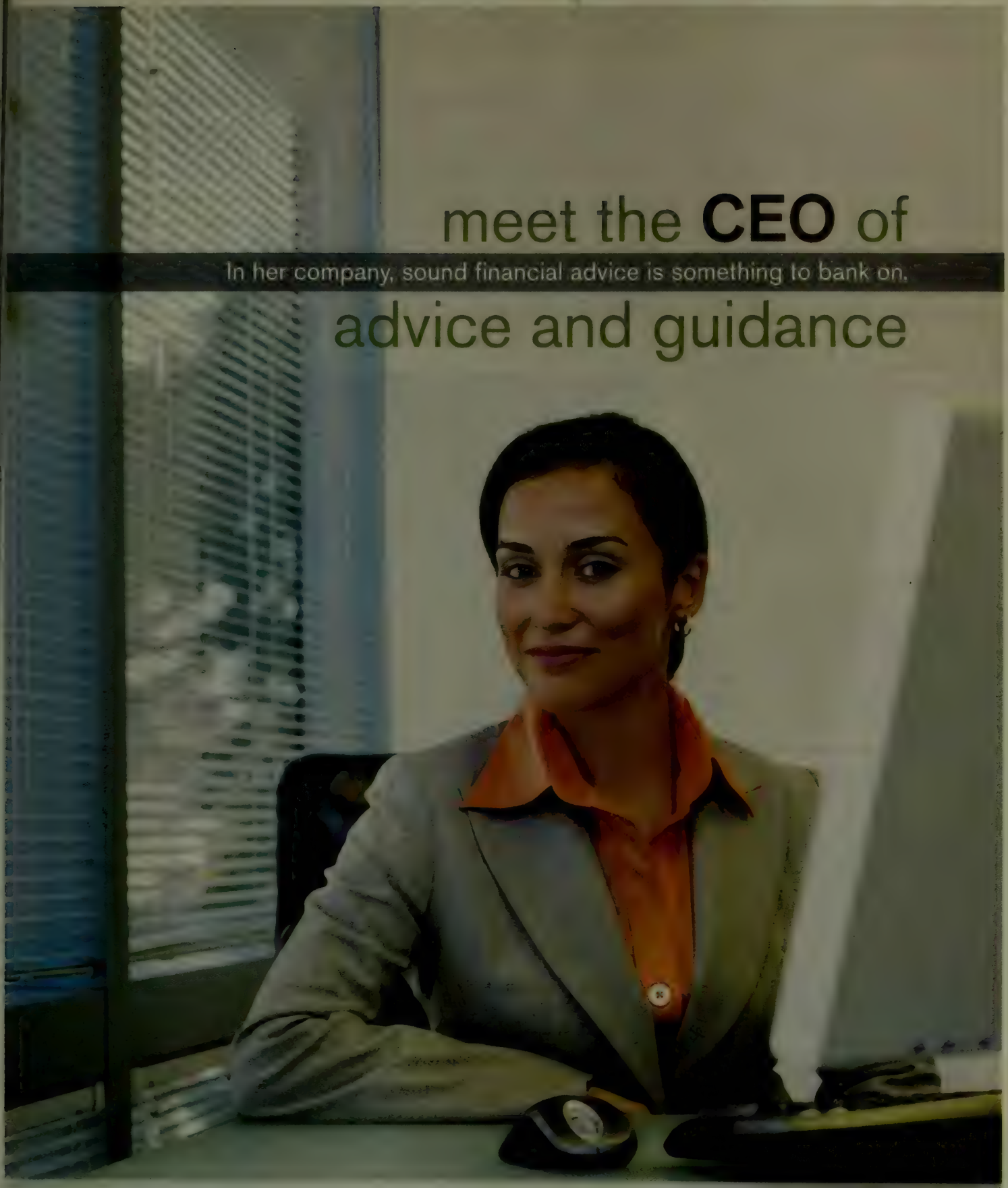

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business problem; analytics are really about aligning strategy and execution. Often, a company must begin by analyzing the problem and its objectives in a greater level of detail.

SAP's Bukary gives this example: A company may decide it wants to cut costs by reducing the average call time from 2.4 minutes to two minutes. This can be accomplished in many ways, such as implementing telephone trees and shorter agent scripts. But the company may discover that customers are leaving because they felt neglected. "The first question people need to ask is 'What's our strategy?'" he says. "If your primary company focus is customer satisfaction, you don't want to implement metrics that run counter to that."

No Bottlenecks

In the past, employees wishing to apply business analytics needed specialists to create the statistical models to make these calculations, which often led to bottlenecks and delays. BI vendors, however, are now making their tools more user-friendly. Furthermore, the embedding of analytics into other applications has enabled the technology to respond in real time. As a result, these composite applications incorporate both transaction processing and analytics.

"People are used to seeing a two-dimensional report," says Rick Miller, practice director for business performance management at Deltek. "Analytics requires getting end users to change their perspective, and employees need to be educated on how to use it."

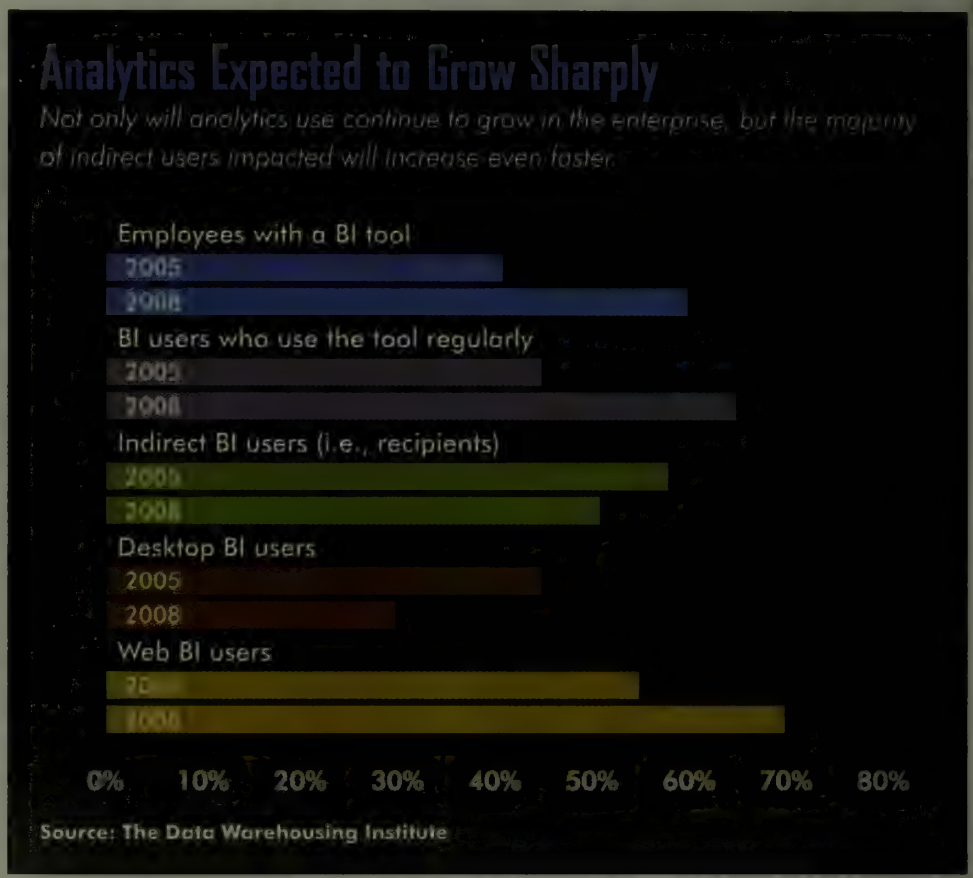
Fortunately, wizards, dashboards, portals and highly intuitive visualization techniques also have simplified this interaction, so analytics are now appropriate for non-technical and sometimes even casual users.

"Business is a team sport, and the challenge is to give analytics in a simple and collaborative way to the people who make decisions, as opposed to keeping it under the control of a couple of guys in the back office," says Patrick Morrissey, a vice president of marketing at Business Objects SA. "Information is more useful when it's in the hands of people who are making decisions and interfacing with customers."

Like any business intelligence project, human factors are always greater stumbling blocks than technological ones. Traditionally, BI is about putting better metrics in front of decision-makers. Analytics takes that a step further by automating the decision-making process. "For people who have never done this before, the biggest hurdle in predictive analytics is trusting the predictive software," says Eric Rogge, vice president and research director at Ventana Research.

"Users don't want to be mathematicians, but they need to know they can trust the data," Morrissey notes. "They need to be able to use their dashboard or reporting system to see such things as when was the last time the data was run and who owns it."

For employees to incorporate analytics into their hectic day-to-day activities, the information must be rendered in a way they can understand and use easily. "A customer rep at a financial institution might not get much benefit if someone applies for a mortgage and a customer value score appears on their computer screen," says Cognos' Alarakhiya. "The analytics application needs to give the rep visibility into that information by saying, 'This customer has had an account for 20 years, their assets with us total over $100,000 and they should receive a loyal customer rate.'"



Key factors for successful analytics are how easy it is to link with data sources and the ease of decision implementation—for example, easily migrating high-value prospects to campaign management once the analytics have identified them. "There is a misconception that you just push a button and this happens," Deltek's Miller says. "A lot of time and thought need to be devoted to what data is needed."

"Besides having a robust statistical model as the basis for predictive results, there are other business variables that need to be taken into account," IDC's Vesset says. "Sometimes a decision has to be taken that contra-

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dicts the data. For example, there may be some customer service variable that overrides the decision a predictive model might have suggested."

Like Skippering a Sailboat

Many people think that advanced analytics are a way to choose the best alternative outcome from a number of choices. In reality, what the technology does is predict a range of possible outcomes. "At the end of the day, predictive analytics can make the decision easier, but it's not a crystal ball," Ventana's Rogge says. "It can narrow the field from an infinite number of outcomes to a smaller subset."

The Data Warehousing Institute's Eckerson points out that even the best analytics models have only a 50 to 60 percent degree of accuracy. "Creating a model is like skippering a sailboat. You have to continually adjust the model to keep it accurate," he says. "The wind is never constant, and sometimes you have to make dramatic shifts."

Advances in technology have sped the process of creating and applying the models used for analytics. Take the time-consuming task of model management. In the past, the majority of the time statisticians spent on analytics projects was putting data in the right format so it could be analyzed. Because newer technology has automated this process, much of the data mining can now be done inside the data warehouse itself.

"Before, statisticians used the warehouse to collect the data, downloaded the data into a high-powered workstation and then uploaded the resulting scores into the data warehouse," Eckerson says. Now, however, companies can use the high-powered data warehouse engines to do the data preparation and scoring, which greatly speeds the process.

Getting the statisticians accustomed to these changes can be difficult, Eckerson notes. He says the statisticians who have done the advance forms of analytics "have been a different breed who need to be brought into the mainstream. They need to understand they need to leverage the existing data infrastructure and not reinvent it."

That's the thing about analytics: It requires a lot of people throughout a company to look at old things in a new way. But once they do, the payoffs can be enormous. ■

Analytics Resources

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BY CATHERINE ARNST

Heart disease is the biggest killer in the industrialized world, making it a critical target for research. On Nov. 13-16, scientists presented 3,800 studies at the American Heart Assn.'s annual Scientific Sessions in Dallas. Some highlights:

INNOVATIONS

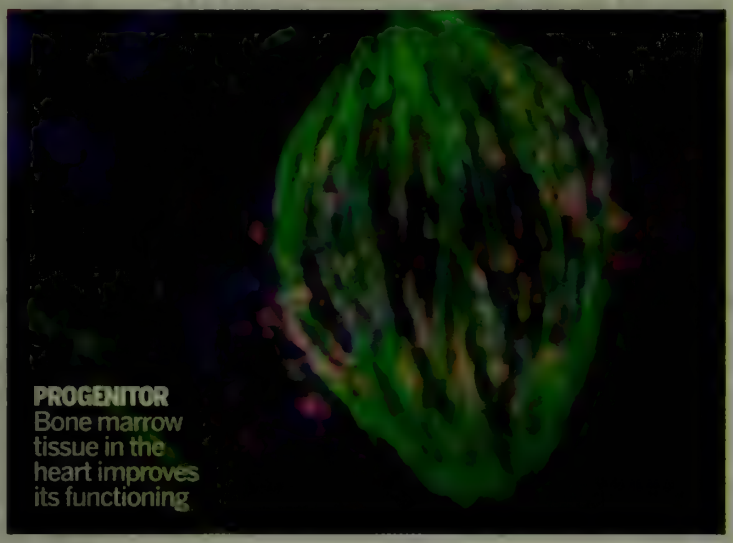
Of smoking bans and nicotine fits

>> Anti-smoking ordinances seem to improve heart health. Heart attack rates fell by 27% in the 18 months after a 2003 ban on smoking in all public spaces took effect in Pueblo, Colo., a city of 104,000 people. The study's lead author, Dr. Mori J. Krantz of the Colorado Prevention Center, says that 399 heart attack patients were admitted to the city's hospitals in the 18 months before the ban went into effect. In a comparable period afterwards, there were only 291 heart attack admissions. Neighboring communities with no smoking ban showed no change in admission rates over the same period. Krantz attributed much of the decline in hospital admissions to a drop in second-hand smoke, which has the ability to worsen cardiovascular health within minutes of exposure.

>> In two studies involving 2,000 smokers, 44% of those taking Pfizer's anti-smoking drug, Varenicline, quit smoking after 12 weeks, compared with 30% on Zyban, an existing GlaxoSmithKline product designed to ease nicotine cravings. Only 17.7% of those on a placebo quit. In a one-year, follow-up study, 22.1% of the Varenicline group were smoke-free, Pfizer reports.

TRANSPLANTS

CELLS TO PUMP UP THE HEART



PROGENITOR Bone marrow tissue in the heart improves its functioning

USING STEM CELLS to repair damaged organs is still more dream than reality. But researchers are getting close with heart disease—especially when they use progenitor cells that are derived from stem cells found in the patients' bone marrow.

Embryonic stem cells can develop into many tissues, including bone, muscle, or heart. But in experiments, they have proved difficult to control—whereas adult progenitor cells seem to obey orders. In a study involving 204 patients at 17 medical centers in Europe, a team led by Dr. Volker Schachinger of Goethe University in Frankfurt infused progenitor cells into the hearts of half of the group, while the other half received placebo infusions. After four months, the hearts of patients who received the cells showed twice as much pumping activity as the control group. And the benefits were most pronounced in those patients who had suffered the most damage from heart attacks.

CHOLESTEROL

STATIN, WHERE IS THY STING?

STATIN DRUGS fight heart disease by lowering "bad" cholesterol, called low-density lipoprotein (LDL). But the drugs may be bumping up against their limitations. In a six-year study of 8,800 patients, half were given 80 milligrams of Pfizer's Lipitor while the other half got 20 to 40 mg of Merck's statin Zocor. Although the Lipitor group achieved lower LDL levels, there was no great disparity in overall death rates, acute heart attacks, or cardiac arrest, compared with the Zocor group. The study was headed by Norway's Dr. Terje Pedersen of Ulleval University Hospital in Oslo.

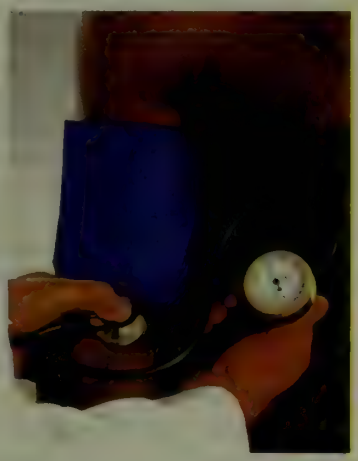
BLOOD PRESSURE

THAT OLD CUFF MAY NOT DO THE JOB

HOW USEFUL IS that inflatable cuff that measures blood pressure in the arm? Doctors have long assumed this widely used measure reflected blood pressure throughout the body, but now it appears that pressure around the heart can be very high—a sign that a heart attack could be imminent—and still be normal in the arm.

A research team led by Dr. Bryan Williams of Britain's University of Leicester tested the standard arm cuff against the SphygmoCor system made by Australia's AtCor Medical in Sydney. This computerized monitoring device estimates pressure in the central aorta by measuring the pulse wave in the wrist.

The researchers were particularly eager to find out why patients in an earlier study who took Norvasc, a blood-pressure-lowering drug from Pfizer, had a 14% lower risk of death than those on beta blockers and diuretics, despite virtually identical blood pressure readings. Testing 2,199 patients with the SphygmoCor, they found substantial differences in blood pressure around the heart between the two groups.



(CLOCKWISE FROM TOP) J. WATERS AND A. SALIC/PHOTO RESEARCHERS INC.; SATURN STILLS/PHOTO RESEARCHERS INC.; HUGH BEEBOWER/CORBIS

My, How You've Grown

A wave of drugs for short kids is sparking controversy—and an expanding market

BY ARLENE WEINTRAUB

IN THE FOURTH GRADE, ANGELO Tufano was so short he looked like a kindergartner, and he was miserable. "I was picked on a lot. Other kids called me 'midget' and 'shrimp,'" says Angelo, now an 18-year-old student at Columbia College in Chicago. "I used to cry." His mother, Carmela, persuaded an endocrinologist to prescribe a growth hormone, even though tests showed he didn't qualify for a prescription. Eventually she talked her insurance company into dropping the monthly co-pay for the drug from $700 a month to $5. Now Angelo stands at 5-foot-9—a full 10 inches taller than his doctors predicted he'd be without the drug. "I was worried society wouldn't accept him," Carmela says. "As a parent, you do what you have to do."

Parents such as Tufano are suddenly facing a plethora of ways to stack inches onto their height-challenged children. In June, Genentech Inc. quietly won approval from the U.S. Food & Drug Administration to expand the market for its growth hormone, Nutropin, which was approved in the early 1990s to treat children whose bodies don't produce adequate amounts. Now Genentech can also market Nutropin to children, like Angelo, with idiopathic short stature (ISS), meaning they're short for no obvious medical reason. And on Dec. 12, the FDA could approve iPlex from Insmed Inc. in Glen Allen, Va.—the second entry this year in an entirely new class of drugs to treat children whose bodies produce growth hormone but can't benefit from it.

As with earlier treatments for short stature, the latest wave of drugs has met with a chorus of controversy. The companies argue that their products offer a safe way for parents to insure their children against a lifetime of discrimination in work and romance. Critics respond that drugmakers are profiting off a condition that's merely cosmetic. "Society is buying into the idea that someone who's short has a medical problem," says Nancy Worcester, a professor of women's studies at the University of Wisconsin-Madison. In 2003, while serving on an FDA advisory panel, Worcester voted against approving Eli Lilly & Co.'s growth hormone, Humatrope, for ISS. Lilly eventually won. "I'm real worried about the medicalization of shortness," Worcester says.

The concerns are not all sociological. Growth hormones, on rare occasions, can cause dangerous side effects, such as pressure on the brain. Some patients have developed leukemia, though the

STANDING TALL Angelo Tufano, 18, with his mother, Carmela, grew an extra 10 inches

MICHAEL L. ABRAMSON

Height Report

These companies are angling to offer new remedies for height-challenged kids

COMPANY GENENTECH (DNA)
DRUG NUTROPIN

HOW IT WORKS This bioengineered form of growth hormone was originally approved in the early '90s for kids whose bodies don't make enough of it. Now the biotech behemoth can market it for kids who are shorter than the mean, even though their growth hormone levels are normal.

COMPANY TERCICA (TRCA)
DRUG INCRELEX

HOW IT WORKS Approved in August, this protein, called insulin-like growth factor (IGF-1), works with the body's native growth hormone to add inches. The twice-daily injection is for the roughly 6,000 kids who are severely deficient in IGF-1.

link to growth drugs is uncertain. Experts are also troubled by the wide variance in effectiveness: Some children gain only a few inches, while others shoot up.

The debate gets even more heated when economists enter the fray. Studies have long indicated that short adults earn less money than their tall co-workers. New research expands on that finding, showing that even short teenagers who grow into normal-size adults are doomed to earn up to 13% less in the workplace than people who were tall as teens. Daniel Silverman, an assistant economics professor at the University of Michigan who headed the latest study, based it on data from ongoing surveys of more than 17,000 people in Britain and 12,000 in the U.S. Silverman plans to publish additional studies next year. Initial indications show that the earnings gap widens over the short teen's life—again, regardless of how tall an adult he or she becomes. This "height premium," he adds, is comparable to wage gaps caused by race and gender.

Silverman says the earnings disparity isn't classical discrimination—it's not about employers secretly agreeing with the old Randy Newman lyric, "short people got no reason to live." Rather it's because short kids don't participate as much in sports, clubs, and other social outlets, so they have less opportunity to learn social adaptability, team building, and other interpersonal skills. Therefore, he concludes, the possible return on a $25,000-per-year investment in growth hormone—as much as a 2.7% boost in wages for every inch gained—is too tempting to ignore. "If you're worried about a kid's future wages and you want to use a drug, I can't say that's a bad thing to do," Silverman says.

The shortness stigma certainly helps the drug companies. Prior to 2003, when the FDA approved Lilly's drug Humatrope for ISS, sales of that product grew in fits and starts, since it was marketed to children and adults with rare disorders that impeded their growth. Once children could take it without proof of an underlying disease, the climate changed. In 2006, sales should come in at $460 million—40% higher than they were in 2002—estimates Stephen M. Scala, an analyst for SG Cowen Securities in Boston. Last year, U.S. growth hormone sales overall jumped 16%, to $711 million, and they're up 10% in the first nine months of this year, compared with the same period in 2004, according to IMS Health Inc.

Despite the FDA's strict rules for these drugs, sales are rising fast

LIFESTYLE DRUG?

THAT'S A LOT of momentum, considering the harsh restrictions the FDA places on drugmakers in this category. Genentech understands those restrictions all too well. In 1999, the company pleaded guilty to federal criminal charges that it improperly promoted its growth hormone. The company paid a $50 million fine. In 2003, the FDA clarified that doctors should prescribe a growth hormone for ISS only when a child is 2.25 standard deviations below the mean height for age and sex—which translates to roughly the shortest 1.5% of children. And drugmakers must adhere to strict marketing plans. "We can't do any direct-to-consumer advertising, and we monitor the market for inappropriate use," says Dr. Matt Rhoa, director of specialty biotherapeutics for Genentech. The target market, he says, "isn't the kid who's shorter than his classmates. These are very, very short kids."

Despite vigilance on the part of drug marketers, some parents will still be tempted to use growth hormone to try to get Johnny on his high school basketball team. While hard numbers on off-label use are scarce, many physicians fear that growth hormone could be turning into a lifestyle drug demanded by kids, or their parents. Nelly Mauras, chief of the division of endocrinology at Nemours Children's Clinic in Jacksonville, Fla., says one father berated her after she refused to prescribe a growth hormone for his son, who she predicted would grow to 5'9" without it. The father "became absolutely irate," Mauras says, and the child was equally adamant he deserved

COMPANY INSMED (INSM)
DRUG IPLEX

HOW IT WORKS This form of IGF-1 is bound to a second protein that helps prevent the growth-promoting molecule from getting flushed out of the body too quickly, so kids only have to endure injections once a day. It could be approved in December.

COMPANY NOVARTIS (NVS)
DRUG OMNITROPE

HOW IT WORKS This generic form of growth hormone could shave inches off the average $25,000-a-year cost of brand-name versions. The FDA has been slow to approve it, so in September, Novartis unit Sandoz sued the agency to demand a timely decision.

the drug. "He started talking like he was going to be a dwarf." What's likely to happen when Dad goes for a second or third opinion? "No doubt he'll get someone to prescribe it," Mauras says.

Even on-label uses of growth hormones can raise troubling questions. For example, if physicians continue to give them to children who fall below the mean, could the mean rise, too, creating a whole new class of kids who qualify for the drug? The world is already getting taller: In the last 40 years, the mean height of American boys ages 6 to 11 has jumped nearly an inch. While some of the gain may have come from improved nutrition, adding drugs to the mix could fuel the frenzy and draw more children into it. Even if everyone grows, relatively, "There will always be a short cohort," says Ross Feldberg, associate professor of biology at Tufts University. "It's scary."

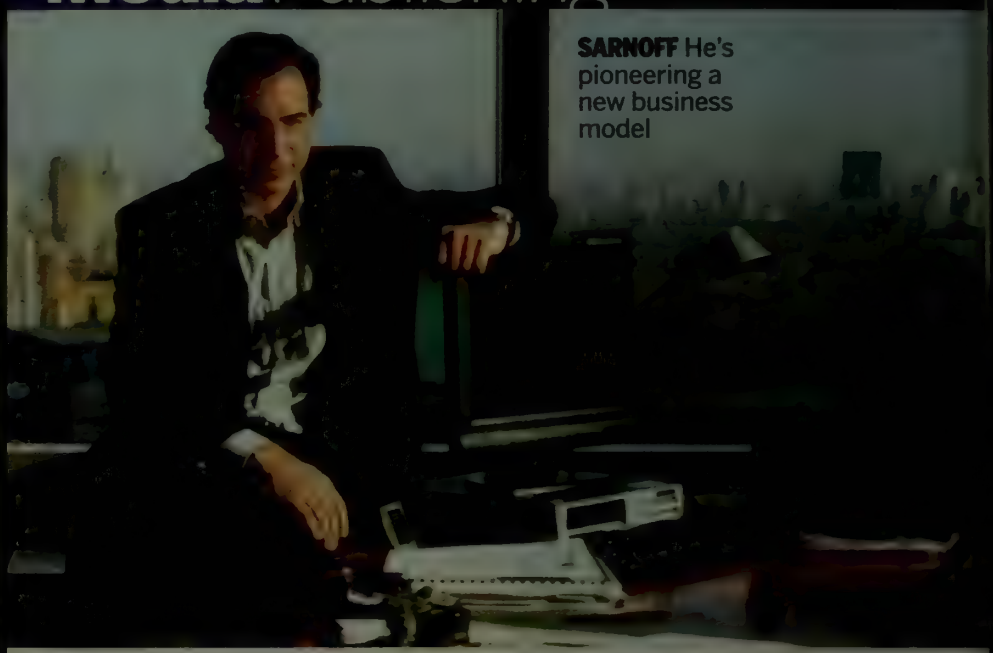
Growth hormones are likely to remain in the spotlight for another reason: They could become the first-ever biotech drugs to become available in generic form. Novartis has been petitioning the FDA to approve its generic-type growth hormone since 2003. Unable to pry loose a response, the company sued the agency in September to force a ruling. Once a cheap alternative becomes available, demand—legitimate and otherwise—could skyrocket.

Soon parents with short children will probably start hearing about a new class of drugs. In August, biotech company Tercica Inc. won FDA approval for Increlex, a protein that could help about 6,000 children a year who don't grow properly. These patients are deficient in a protein, called IGF-1, which is another vital part of the growth process. Rival Insmed could have its form of IGF-1 approved in December, though it has to clear additional regulatory hurdles to market the drug in the U.S. For Carrie Reeb, a 17-year-old who participated in a Tercica trial, IGF-1 has made a world of difference. "I would have been only three feet—about counter height," says Reeb, who lives in Charlotte, N.C., and is now just under five feet. "I'm small, but I'm normal."

Normal, of course, will always be a matter of debate among children, parents, and physicians. And the controversy will grow—side by side with revenues—as new drugs hit the market. ■

–With Michael Arndt in Chicago

BusinessWeek online For more on off-label uses of growth hormone, visit www.businessweek.com/extras



SARNOFF He's pioneering a new business model

Digital Is Our Destiny

Random House is moving beyond print to protect itself from the likes of Google

BY TOM LOWRY

THE FIRST SENSATION that hits as you enter Random House is Manhattan headquarters is a whiff of mustiness coming off the shelves of first editions lining the lobby and hallways. But don't let your nose fool you. The 80-year-old book publisher is pushing beyond the pulp-and-ink era into the digital age.

Unwilling to let a Google, Yahoo!, or Microsoft dictate terms in cyberspace, Random House Inc., the world's largest trade publisher, is taking the industry lead. In early November it outlined ways it would begin to offer its books directly to consumers on a page-per-view basis. Random House will get at least 4¢ a page and split that roughly in half with authors for fiction and narrative nonfiction titles. Other types of books, such as cookbooks, will have different pricing models. Random House is discouraging copying of the texts by delivering pages in low-resolution files.

What's more, Random House says it will launch a movie division, in partnership with production outfit Focus Features, to parlay its books into films. Richard Sarnoff, president of Random House's corporate development unit, says the initiatives are all part of an attempt to assert itself in a fast-changing milieu. "We acknowledge that a generation is growing up that may not have the same visceral connection with the book format," says Sarnoff. "They have read as much on screens as they have on paper. We need vehicles to translate our books in different ways." These new announcements are consistent with a vision for new media that seems to be falling in place at Random House. Other recent deals negotiated by Sarnoff include making investments in Vocel, which delivers educational content to cell phones; Audible Inc. (page 28), a download and CD service; and American Reading Co., which promotes reading in schools by rotating mini-libraries from classroom to classroom.

Book publishers might be expected to be nostalgic and lament the past, but the

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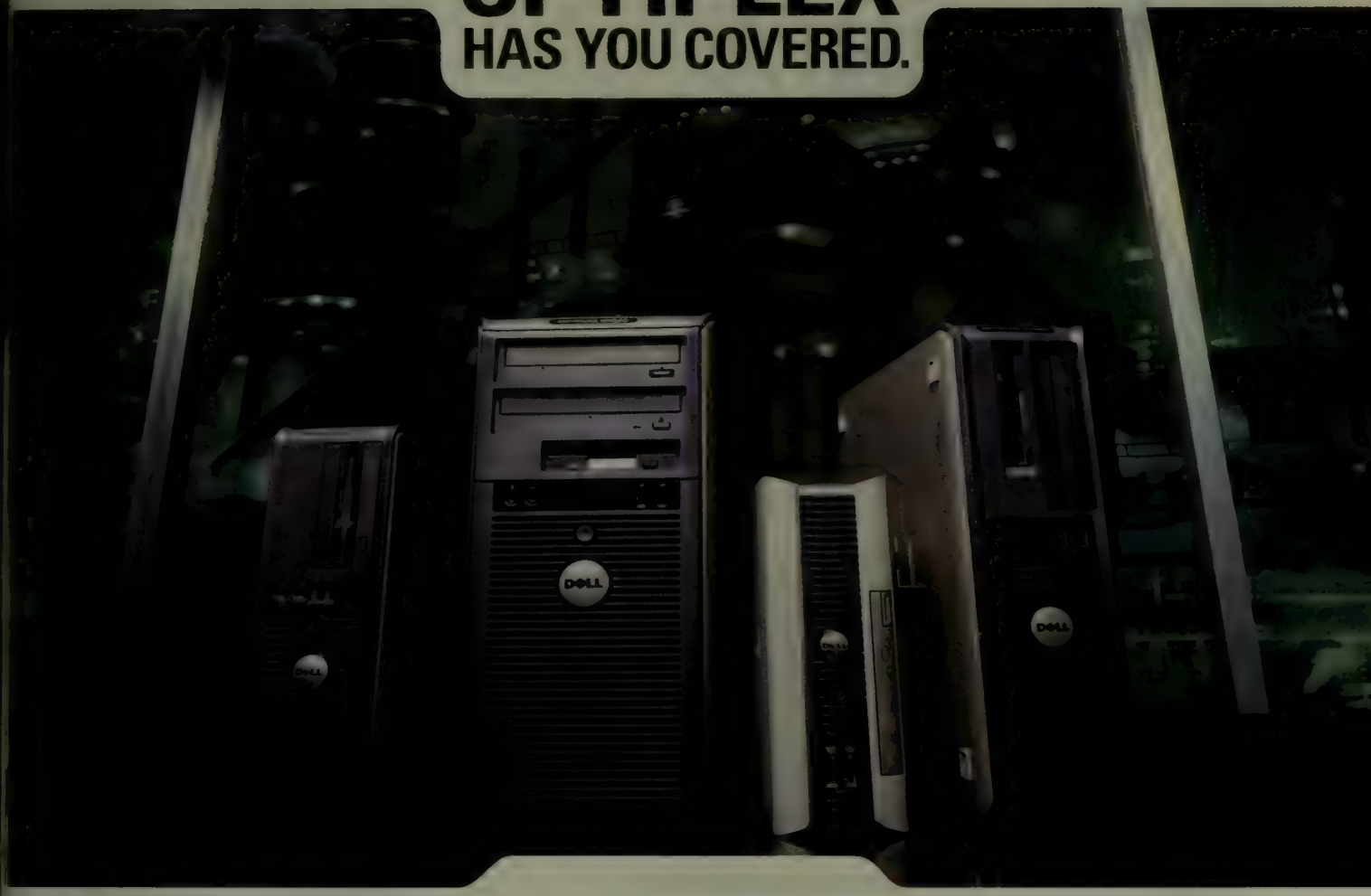

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As the Page Turns

Here's how Random House hopes its new digital model might work:

1 **A FRIEND RAVES TO YOU** about Diana Gabaldon's latest novel in her *Outlander* series, set in 18th-century Scotland.

2 **YOU GO TO AMAZON.COM** and read a chapter for free, about 5% of the total book, but you would like to read more.

tumult they witnessed in the music world sounded the alarm, says Sarnoff, whose great-uncle was RCA Chairman David Sarnoff, a pioneer in the development of radio and TV. "The technology was adopted before there was a business model for legitimate sales," he says. "That created a fertile ground for piracy, and it became ingrained in consumer behavior." The urgency for a new business model in publishing was clear. Sarnoff figures that within 18 months, reading devices could be as easy to use for books as the Apple iPod is for music. "Screen technology is about to get much better very quickly," he says.

The book biz is taking a cue from the music industry

Random House's digital model, whose per-page fees may be pricey for those accustomed to free views, has been in the works for about a year. Sarnoff and his team have taken the time to share their ideas with authors, booksellers, and other publishers. But aggressive moves by the likes of Google Inc. may be speeding things up. Taking a page from the music industry's legal crackdown against piracy, Random House, along with four other publishers (including *BusinessWeek* parent The McGraw-Hill Companies), in October sued Google, arguing that its plan to scan millions of library books for Internet viewing violates copyright laws. Google has said it is well within "fair use" exceptions in the law. The Authors Guild, with 8,000 members, filed a similar lawsuit against Google in September. "The elephant in the room for all of us is Google," says author James Gleick, whose book *Isaac Newton*, published by a Random House imprint in 2003, was a Pulitzer prize finalist. Yahoo! Inc. and Microsoft Corp. also plan to make

3 **YOU DECIDE TO BUY** three more chapters, about 60 or so pages, for about $3 total, or whatever Amazon decides to charge you.

4 **RANDOM HOUSE GETS 4¢ A PAGE**, or $2.40. Gabaldon will get a percentage of that as part of a permission sale.

5 **YOU DECIDE YOU LOVE THE BOOK** but you really don't want to read it all online, especially since you are heading out of town.

6 **YOU RUN TO YOUR LOCAL BARNES & NOBLE** on your way home to pack and plunk down $20 for the book.

books available online but with approval from publishers. Online retailer Amazon.com Inc., too, has announced a pay-per-page offering.

STAKING CLAIM

RANDOM HOUSE, a unit of German media conglomerate Bertelsmann, publishes 10,000 new titles worldwide and generates about $2 billion in revenue a year. It has often been derided for its top-down approach in a business that had been relatively decentralized among many imprints. But even some of its staunchest critics say that Random House's heft may be just what publishing needs to protect its interests. "It's important that Random House planted the stake," says Jane Friedman, CEO of HarperCollins Publishers, a unit of News Corp., adding that her company will soon be unveiling business models that may have direct tie-ins with some of Murdoch's new online acquisitions. "Everybody now wants to digitize all intellectual property," Friedman says. "That's good for publishers because we control [it]. Everything keeps changing, but this ultimately will be a healthy time for books. We just have to make sure [digital sales] get done right."

It's too early to tell how disruptive this will be to traditional bookselling. For one thing, top retailer Barnes & Noble declined to comment on Random House's scheme. Just the same, digital sales won't resolve the biggest problem in the industry, "the one upsetting the whole ecosystem," says Paul Aiken, executive director of the Authors Guild. Authors and publishers are almost never compensated for used-book sales, which total about $2.2 billion a year. Still, Aiken is encouraged that at least one publisher is trying to keep that dynamic from being repeated online. By coming up with its own way to sell books digitally, says Aiken, Random House is declaring to the Googles and Yahoos "this is our job, not yours." ■

Some steps to take to emit less.

Recently BP launched a five-year, $350 million company-wide program to implement technologies and processes that will reduce greenhouse gases, with a goal of eliminating 4 million tonnes of emissions over the next 4 years. And there are actions we all can take, like installing solar panels and carpooling. To learn more, visit bp.com/carbonfootprint
It's a start.

bp

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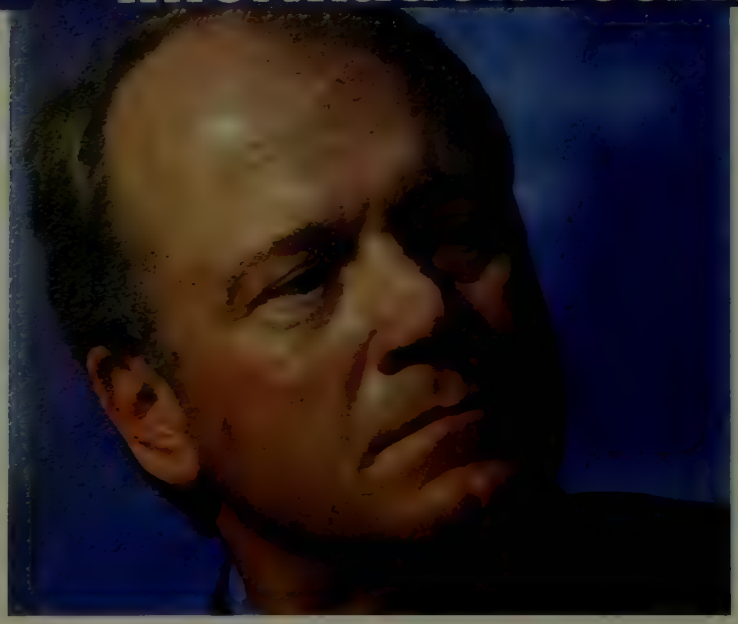


CHAMBERS AND GATES The companies insist there's no conflict

Goliaths on a Collision Course?

As the tech world evolves, Microsoft and Cisco will go head to head in new markets

BY PETER BURROWS AND OLGA KHARIF

MICROSOFT HAS NO shortage of rivals. There's IBM in corporate software, Sony in computer games, Apple in digital music, plus Google and Yahoo! on the Web. But more and more, Microsoft is coming up against a new competitor: Cisco Systems.

Cisco? Talk to the companies and, rather than describing a rivalry, they'll list the many ways in which they're collaborating. They've worked together on such products as small-business call centers and set-top boxes. But there's rising competition on other fronts where growth is expected to be brisk, namely security software and Internet telephone technology. So while the two companies compete only in pockets today, researcher Gartner Inc. thinks the overlap will grow to markets worth $20 billion in six years. "You have two Goliaths that need to find bigger pieces of new spending, and they're going to bump heads," says JMP Securities LLC analyst Sam Wilson. "It could get nasty."

What's at the root of the increasingly complex relationship between Microsoft, the world's largest software maker, and Cisco, the No. 1 maker of computer networking gear? It's the shift in the tech industry's center of gravity—from the PC, where Microsoft has ruled, to the network, where Cisco is dominant. As more computing tasks are handled online, from Web searches to downloading movies, Cisco CEO John Chambers is focusing on infusing networks with the smarts that typically have been the province of Microsoft-style applications. "Cisco's strategy has been to move intelligence to the core of the network," says 3Com Corp. CEO Bruce Claflin. "Microsoft wants the intelligence to be in [PCs and other devices], at the edge of the network."

THE STAT

$20 BILLION

Value of markets in which Microsoft and Cisco will compete by 2011, up from almost nothing today.

Data: Gartner Inc

Consider some of the new areas Cisco is wading into: On Nov. 14 the company announced an initiative aimed at small and midsize companies. It's called Linksys One, after Cisco's unit that specializes in home-networking gear. Now Cisco will sell routers that come preconfigured to offer basic networking as well as phone, video, and related applications. By combining all those features in one box, Cisco could potentially grab share in markets Microsoft is targeting as well, such as Net phone systems and security. Cisco has dubbed this market an "emerging technology," which it defines as one that has the potential to be a billion-dollar business for the company.

A second initiative, announced in June, creates smarter networks that simplify and speed up corporate computing tasks. For example, a network could be programmed to notify the head of sales the moment a customer places a $1 million-plus order, or to automatically send out a "thank you" form letter. The software also lets different applications talk to each other more easily—say, to ensure that a purchase order flows from the online store through various back-office applications. "Networking is moving from a way to connect things to a way to enhance productivity," says Cisco Senior Vice-President Jayshree Ullal.

Microsoft is by no means standing still. As part of Chairman William H. Gates III's push to deliver software over the Internet, the company announced in October that it will create two families of Web

ervices—Windows Live and Office Live—as online counterparts to its Windows and Office software franchises. Microsoft also has been pouring money into software that would let Windows users work together over a network. "It's a very strategic area for us, and the investments we're making are similar, if not greater, than the investments we made around Office," says Zig Serafin, general manager for real-time collaboration at Microsoft.

The big question is whether the two companies will butt heads or partner up. "They're infringing on each other's territory in a variety of ways," says Simon Khalaf, CEO of Vernier Networks Inc., a network security company that competes with Cisco and partners with Microsoft. "If they can work together, it would be great for the industry. If there's war, it's going to be ugly."

WISHFUL THINKING?

THE COMPANIES ARE striving to collaborate when they can. On Nov. 10, Cisco and Microsoft announced that they will support a standard designed to make Internet phone calling and video services work inside corporate firewalls with fewer glitches.

The companies will also have a joint marketing arrangement to make it easy for smaller companies to integrate some Microsoft business applications with Cisco networks. "There's always overlap, especially when you look at an industry that evolves as fast as this one," says Microsoft's Serafin.

Cisco Senior Vice-President Dan Scheinman says the companies are collaborating on a range of other fronts, such as creating new "presence-based" applications that let workers get only the data they need in a given location—say, on the factory floor. "In spite of a lot of analyst commentary, I've seen more meat to our collaboration in the last few years," says Scheinman. "Microsoft is dealing with the impact of the Internet revolution. Our hope and our goal is to work with them, to create opportunity for both of us."

Wishful thinking? Many observers believe so. This isn't the first time the companies have been on a collision course. Back in 2002, Microsoft launched its own line of wireless home routers. Two years later it exited the market amid escalating competition from Linksys, a division Cisco bought in 2003. That retreat was quickly forgotten. The same may not be true for the conflicts to come. ■

No BlackBerry, No Life

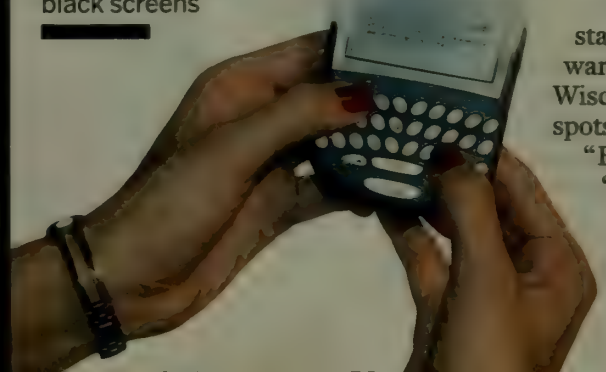
"I'm addicted to this thing," says one CEO. But what if the connection shuts down?

BY HEATHER GREEN

WHAT WOULD A DAY without the BlackBerry be like? John A. Edwardson, chief executive of tech distributor CDW Corp., ponders the question over a breakfast of poached eggs, bacon, and decaf in a Manhattan hotel. He picks up his BlackBerry from the table, turns it over, then can't bring himself to imagine such a dire possibility. "Let me get this out up front: I'm addicted to this thing," he says. "Seriously, in my opinion, this is the most important productivity tool that has come out in my lifetime. You think of something in the middle of the night. Bang. You take care of it right away."

Unless, of course, the BlackBerry gets squashed. While that's a long shot, a U.S. district court judge in Virginia is hearing a case that could lead to the shutdown of BlackBerry service in the U.S., at least temporarily. Patent holding company NTP Inc. is suing Research In Motion Ltd., BlackBerry's Canadian maker, alleging its wireless e-mail technology infringes on NTP patents. Unless the two sides reach a settlement, NTP has asked the judge, who has already ruled that NTP's claims have merit, to turn off RIM's service in the U.S.

THUMB FUN An infringement suit could mean black screens



If that were to happen, Edwardson and 2.8 million other BlackBerry addicts from Hollywood to Wall Street would find themselves staring at black screens. It's a serious enough risk that the Justice Dept. filed a motion on Nov. 10 asking the court to ensure that people in the federal government itself would be exempt from any injunction.

So Senate Majority Leader Bill Frist may be able to zip off e-mails to his staffers. But what happens to everyone else? What would the costs be of going without BlackBerry? Well, soccer games, for one. Peggy Foran, executive vice-president at Pfizer Inc., hightails it out of the office at 3 p.m. on game days so she can root for her daughter from the sidelines. No BlackBerry, no cheering for her. She admits to using it in less admirable spots, too. One time she was so busy typing e-mails in church during Easter mass that her daughters confiscated the machine. "I couldn't go back to not using one," she says.

Anthony Paduano figures he could go without—for about 20 minutes. His law firm, Paduano & Weintraub LLP, is a litigation specialist with 13 senior lawyers in New York. "We advertise ourselves as a little boutique of trial lawyers who can go anywhere and be available anytime," says Paduano. "If you take our BlackBerries away, we wouldn't be able to do that. We would have to spend all our time trying to find a Kinko's."

No wonder people are eager to stay connected. So addicted is Edwardson that he circles his cabin in Wisconsin searching for the nearest spots where he can use his BlackBerry. "Every year it gets closer," he says. "It used to be five miles away. Now there's a hill about two miles away where I can get a signal." ■

Meet Jane Geek

With women accounting for 50% of technology purchases, Dell, Samsung, and others are opening the door for them

BY PALLAVI GOGOI

MANAGERS from Dell Inc.'s marketing and public relations staff flew from their Round Rock (Tex.) headquarters to New York earlier this year to meet with editors and sales reps at a dozen publications. Their mission wasn't too surprising: Get editors to print more about their computers, televisions, and pocketPCs.

It was the choice of magazines that was unusual, including Oprah Winfrey's *O at Home*, *Ladies' Home Journal*, and *CosmoGIRL*—not exactly publications on the company's regular radar screen, despite the obviously large number of women tapping keyboards in offices and cafés. In barely six months, though, Dell's laser printer, plasma TV, and notebook computer were featured as must-haves in gift guides in shelter magazines *Real Simple* and *O at Home*. And in August, *CosmoGIRL* gave Dell's 700m, 4-lb. notebook a "kiss of approval."

Dell isn't the only consumer electronics giant to have slept through the alarm when it comes to realizing that women are as interested as men in personal computing and home entertainment. RadioShack, Best Buy, and Samsung, too, have only recently begun to make big changes to their marketing plans, store designs, and products with women in mind. In an effort to avoid commodity status in crowded categories like TVs and PCs, they have dug deeper into customer's heads. Marketing executives noticed that women are much more involved in buying electronic gadgets but are completely underserved. Indeed this year, for the first time, women are expected to outspend men in the $122 billion market, according to the Consumer Electronics Assn.

It didn't take long, once it tuned in, for Dell to register that women are its fastest-

CHRISTOPH HITZ

rowing customer group and key to its rowth strategy, especially as it branches ut to TVs and MP3 players. Its own research in 2004 showed women made up alf of its buyers and were as likely as ien to prefer buying PCs online. So besides the women's magazines, Dell is running ads on women-centric cable-TV hannels such as Oxygen and Lifetime elevision. It also placed a Dell TV and iptop on the set of Martha Stewart's new IBC daytime show. Before that, says Bobi Dangerfield, director of customer experience, "you wouldn't have seen any Dell ds on these women's channels."

Blame the male geek culture at digital ardware marketers for ignoring women i the past. As recently as early 2003, amsung Electronics tested its phones, Vs, and home theaters with all-male fous groups. Today, the company makes ure half its reviewers are women. The ayoffs: Samsung designed its Duo-Cam—the first two-lens digital camera nd camcorder—after women reported hey liked to record "life events" both in hotographs and video but didn't like to ug around two gadgets. The camera reently became lighter by 40%, again the esult of female feedback.

CHIEF PURCHASING OFFICER

AMSUNG HAS BESTED its rivals in design awards the past two years, an acomplishment that Peter Weedfald, senior ice-president for sales and marketing at Samsung Electronics America Inc., atributes to listening to women. "Have you ver heard a man say: 'I wish they would hange the design and color of this product and make it easier to use?'"

Demographics have a role to play in his shift. Women now head 33 million ouseholds, up from 21 million in 1980. Their buying power has grown, too. In he past three decades, men's median income has barely budged, up just 0.6%, vhile women's has soared 63% (though vomen still earn less than their male counterparts—78¢ for every dollar a man gets). And women need plenty of computing power given they are starting businesses at twice the rate of men, according to the Center for Women's Business Research.

The digital home has also come to confer on women the role of chief purchasing officer of computing and entertainment gear. They're judging the user-friendliness of computers and wireless networks just as they would stoves and refrigerators. "Last week my 11-year-old came in and said she needed a JumpDrive to transfer digital files back and forth from school, and who buys it? My wife," says Paul Rand, chief development and innovation officer at communications firm Ketchum, which led a standing-room-only marketing-to-women forum at the Consumer Electronics Show last February.

Best Buy has caught on to the women's digital mind-set, too, launching its "Jill Initiative" to focus on what women want. "Jill," according to the retailer, is a time-pressured suburban mom who prefers shopping at Target Corp., because of its focus on style, over, say, Wal-Mart Stores Inc. In the past year, Best Buy relaunched 60 stores, changing their look with pastel colors rather than the chain's traditional dark-blue and yellow scheme to create a more soothing experience. Personal shopping advisers whisk mostly female shoppers around the stores, steering clear of tech jargon. "The language of bits and bytes is a thing of the past," says Ketchum's Rand. A Best Buy salesperson doesn't talk megapixels but instead asks if a digital camera is primarily for still photos or soccer games and if buyers plan to print their own photos.

REMOTE FIX-IT

WOMEN ARE FAR less likely than men to feign understanding of new technology, and thus they expect a high level of customer service. So Best Buy launched the Geek Squad service, whose men and women in white shirts and ties go so far as to offer home visits in a white-and-orange Volkswagen Beetle to fix, upgrade, and install hardware and software. Dell, meanwhile, last week rolled out Dell On Call, which allows its help desk to take over a computer remotely and fix it for customers who sign on.

Perhaps consumer electronics marketers wouldn't have taken so long to appreciate women if they had a few more in their ranks. Dell, for one, laments that women are only a third of its management ranks. Last March it held a diversity summit with 30 other companies to form a strategy to attract more women as employees, not just customers. "It's important that our employees reflect our customer base," says Stephanie Mims, senior manager of global diversity at Dell.

Some may view these efforts as pandering, the way auto makers in the 1950s tried pitching cars with matching handbags. But some see clear differences between the genders. RadioShack Chief Marketing Officer Don Carroll says women behave differently from their first step in the store, based on studying his in-store-motion cameras. "Men look left and right, identify their product, and head towards it, but women really shop the store before reaching their goal," says Carroll. He's changing lighting at the company's 5,000 outlets and making the stores less cluttered, a leading complaint among women and a move that will no doubt make it easier for men to shop as well. It's Mother, it seems, who knows best in the gadget aisle. ■

Tech's Come A Long Way Baby

This is the year the world's consumer-electronics makers discovered the importance of women consumers. Here's how they're targeting them—and designing products women want:

BEST BUY

The retailer's "Jill Initiative" led to a massive redesign of 60 stores with pastel colors rather than the traditional dark blue and yellow. It also introduced personal shopping assistants aimed at making women feel comfortable.

DELL

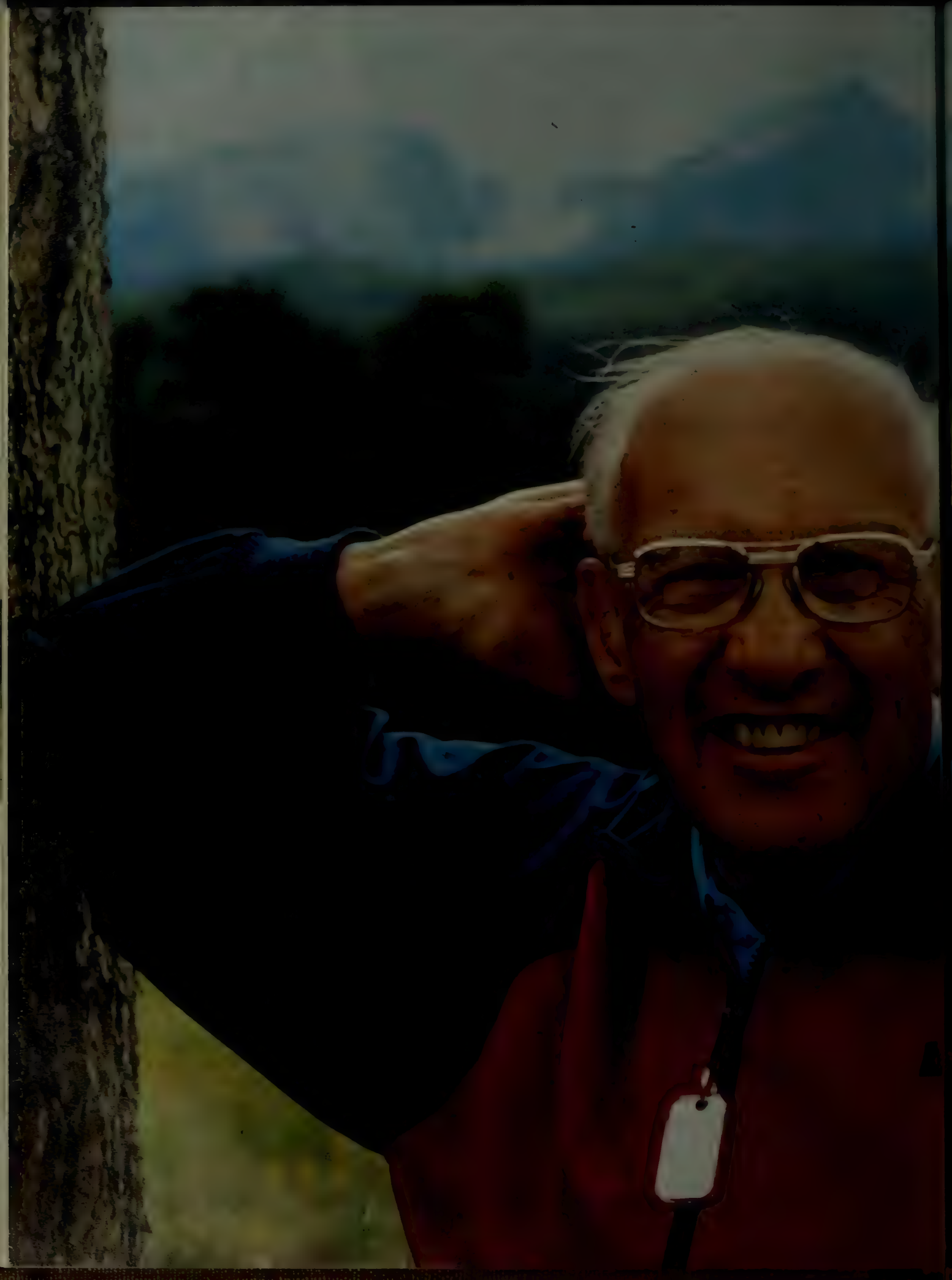
The PC company, which recently delved into flat-panel TVs, has courted women's-magazine editors for reviews and peppered Martha Stewart's show with products.

DECORATING DIVA Martha does Dell

SAMSUNG

The Korean manufacturer has racked up a slew of design awards, for which management credits the increased presence of women on its consumer panels and focus groups—from zero to 50% over the past two years. Women, it seems, make the mostly male designers do a better job.

DUO-CAM Two lenses



THE MAN WHO INVENTED MANAGEMENT

Why Peter Drucker's ideas still matter

BY JOHN A. BYRNE

LITTLE MORE THAN six months ago, I was sitting within a foot of Peter F. Drucker's right ear—the one he could still hear from—in the living room of his modest home in Claremont, Calif. Even that close, I had to shout my questions to him, often eliciting a "What?" rather than an answer. Yet when he absorbed my words, his mind remained vigorous even as his body was failing.

He had often said that at his age "one doesn't pray for a long life but for an easy death." Since then he had struggled through a series of ailments, from life-threatening abdominal cancer to a broken hip. Oversize hearing aids plugged into both ears, he had a pacemaker in his chest and needed a walker to get around his ranch home on Wellesley Drive. Over 20-plus years, I often met or spoke to Drucker in the course of reporting any number of business and management stories.

On that spring morning in April, in black cotton slippers and socks that barely covered his ankles, Drucker seemed unusually frail and tired—not at all in a mood to ponder his legacy. "I'm not very introspective," he protested in his familiar guttural baritone, thick with the accent of his native Austria. "I don't know. What I would say is I helped a few good people be effective in doing the right things."

Let others now speak for Drucker, who died peacefully in his sleep at home on Nov. 11 at age 95, eight days shy of his 96th birthday:

"The world knows he was the greatest management thinker of the last century," Jack Welch, former chairman of General Electric Co., said after Drucker's death.

"He was the creator and inventor of modern management," said management guru Tom Peters. "In the early 1950s, nobody had a tool kit to manage these incredibly complex organizations that had gone out of control. Drucker was the first person to give us a handbook for that."

Adds Intel Corp. co-founder Andrew S. Grove: "Like many philosophers, he spoke in plain language that resonated with ordinary managers. Consequently, simple statements from him have influenced untold numbers of daily actions; they did mine over decades."

The story of Peter Drucker is the story of management itself. It's the story of the rise of the modern corporation and the managers who organize work. Without his analysis it's almost impossible to imagine the rise of dispersed, globe-spanning corporations.

But it's also the story of Drucker's own rising disenchantmen with capitalism in the late 20th century that seemed to rewar greed as easily as it did performance. Drucker was sickened b the excessive riches awarded to mediocre executives even as the slashed the ranks of ordinary workers. And as he entered hi 10th decade, there were some in corporations and academia wh said his time had passed. Others said he grew sloppy with th facts. Meanwhile, new generations of management gurus an pundits, many of whom grew rich off books and speaking tour superseded him. The doubt and disillusionment with busines that Drucker expressed in his later years caused him to tur away from the corporation and instead offer his advice to th nonprofit sector. It seemed an acknowledgment that busines and management had somehow failed him.

But Drucker's tale is not mere history. Whether it's recog nized or not, the organization and practice of management to day is derived largely from the thinking of Peter Drucker. Hi teachings form a blueprint for every thinking leader (page 106 In a world of quick fixes and glib explanations, a world of fad and simplistic PowerPoint lessons, he understood that the jo of leading people and institutions is filled with complexity. H taught generations of managers the importance of picking th best people, of focusing on opportunities and not problems, o getting on the same side of the desk as your customer, of th need to understand your competitive advantages, and to con tinue to refine them. He believed that talented people were th essential ingredient of every successful enterprise.

RENAISSANCE MAN

WELL BEFORE HIS DEATH, before the almost obligatory acco lades poured in, Drucker had already become a legend, o course. He was the guru's guru, a sage, kibitzer, doyen, an gadfly of business, all in one. He had moved fluidly among hi various roles as journalist, professor, historian, economics com mentator, and raconteur. Over his 95 prolific years, he had bee a true Renaissance man, a teacher of religion, philosophy, po litical science, and Asian art, even a novelist. But his mos important contribution, clearly, was in business. What John Maynard Keynes is to economics or W. Edwards Deming to quality, Drucker is to management.

After witnessing the oppression of the Nazi regime, he found great hope in the possibilities of the modern corporation to build communities and provide meaning for the people who

FATHER OF MODERN MANAGEMENT The story of Peter Drucker i

1909 Nov. 19: Peter F. Drucker born into a highly educated professional family in Vienna, Austria. His father, Adolph, was an economist and lawyer, his mother, Caroline, had studied medicine.

1927 Moves from Austria to Germany to study law at Hamburg University.

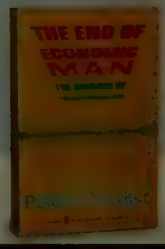
1929 Joins Frankfurt's largest daily newspaper as a financial writer. His first story: the stock market crash.

General Anzeiger
Panik an der New Yorker Börse.

1932 Publishes pamphlet that offends the Nazis. Pamphlet is banned and burned.

1937 Marries Doris Schmitz and moves to the U.S. as a correspondent for British newspapers.

1939 Publishes first book, *The End of Economic Man: The Origins of Totalitarianism*, which becomes a favorite of Winston Churchill.



1945 Publishes *Concept of the Corporation*, a landmark study of General Motors. The book introduces decentralization as a principle of organization.

195 Joins New University managem professor

(L TO R) WWW.PETERDRUCKER.AT; COURTESY CLAREMONT GRADUATE UNIVERSITY

> "The world knows he was the greatest management thinker of the last century"
> —*Jack Welch*

worked in them. For the next 50 years he would train his intellect on helping companies live up to those lofty possibilities. He was always able to discern trends—sometimes 20 years or more before they were visible to anyone else. "It is frustratingly difficult to cite a significant modern management concept that was not first articulated, if not invented, by Drucker," says James O'Toole, the management author and University of Southern California professor. "I say that with both awe and dismay." In the course of his long career, Drucker consulted for the most celebrated CEOs of his era, from Alfred P. Sloan Jr. of General Motors Corp. to Grove of Intel.

- It was Drucker who introduced the idea of decentralization—in the 1940s—which became a bedrock principle for virtually every large organization in the world.
- He was the first to assert—in the 1950s—that workers should be treated as assets, not as liabilities to be eliminated.
- He originated the view of the corporation as a human community—again, in the 1950s—built on trust and respect for the worker and not just a profit-making machine, a perspective that won Drucker an almost godlike reverence among the Japanese.
- He first made clear—still the '50s—that there is "no business without a customer," a simple notion that ushered in a new marketing mind-set.
- He argued in the 1960s—long before others—for the importance of substance over style, for institutionalized practices over charismatic, cult leaders.
- And it was Drucker again who wrote about the contribution of knowledge workers—in the 1970s—long before anyone knew or understood how knowledge would trump raw material as the essential capital of the New Economy.

Drucker made observation his life's work, gleaning deceptively simple ideas that often elicited startling results. Shortly after Welch became CEO of General Electric in 1981, for example, he sat down with Drucker at the company's New York headquarters. Drucker posed two questions that arguably changed the course of Welch's tenure: "If you weren't already in a business, would you enter it today?" he asked. "And if the answer is no, what are you going to do about it?"

Those questions led Welch to his first big transformative idea: that every business under the GE umbrella had to be either No. 1 or No. 2 in its class. If not, Welch decreed that the business would have to be fixed, sold, or closed. It was the core strategy that helped Welch remake GE into one of the most successful American corporations of the past 25 years.

Drucker's work at GE is instructive. It was never his style to bring CEOs clear, concise answers to their problems but rather to frame the questions that could uncover the larger issues standing in the way of performance. "My job," he once lectured a consulting client, "is to ask questions. It's your job to provide answers." Says Dan Lufkin, a co-founder of investment banking firm Donaldson, Lufkin & Jenrette Inc., who often consulted with Drucker in the 1960s: "He would never give you an answer. That was frustrating for a while. But while it required a little more brain matter, it was enormously helpful to us. After you spent time with him, you really admired him not only for the quality of his thinking but for his foresight, which was amazing. He was way ahead of the curve on major trends."

Drucker's mind was an itinerant thing, able to wander in minutes through a series of digressions until finally coming to

y of the rise of management as a profession

54
actice of
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What is
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F. DRUCKER
Practice of agement

1966
The highly regarded *The Effective Executive*, tells managers to focus workload to avoid "wasting time" on nonessential matters.

1971
Leaves NYU to teach at Claremont Graduate School in California; Claremont eventually renames the school after him.

1975
Begins 20-year tenure as a monthly columnist for *The Wall Street Journal*.

1981
His insightful questions to Jack Welch lead to GE's cornerstone strategy of striving to be No. 1 or No. 2 in every business.

1984
Drucker famously argues that a CEO should make no more than 20 times the salary of the lowest-paid worker.

2002
Awarded the Presidential Medal of Freedom by President George W. Bush.

2005
Nov. 11: Drucker, dies at age 95, having published 38 books translated into 37 languages.

(CLOCKWISE FROM TOP) ADAM ROUNTREE/BLOOMBERG; COURTESY OF CLAREMONT GRADUATE UNIVERSITY; GUNTMAR FRITZ/ZEFA/CORBIS; COURTESY CLAREMONT GRADUATE UNIVERSITY

some specific business point. He could unleash a monologue that would include anything from the role of money in Goethe's *Faust* to the story of his grandmother who played piano for Johannes Brahms, yet somehow use it to serve his point of view. "He thought in circles," says Joseph A. Maciariello, who teaches "Drucker on Management" at Claremont Graduate University.

Part of Drucker's genius lay in his ability to find patterns among seemingly unconnected disciplines. Warren Bennis, a management guru himself and longtime admirer of Drucker, says he once asked his friend how he came up with so many original insights. Drucker narrowed his eyes thoughtfully. "I learn only through listening," he said, pausing, "to myself."

Among academics, that ad hoc, nonlinear approach sometimes led to charges that Drucker just wasn't rigorous enough, that his work wasn't backed up by quantifiable research. "With all those books he wrote, I know very few professors who ever assigned one to their MBA students," says O'Toole. "Peter would never have gotten tenure in a major business school."

> "Peter was saying the nonprofit sector is the equal partner of business and government when most people saw it as sort of a junior partner"
> —*Frances Hesselbein*

I first met Drucker in 1985 when I was scrambling to master my new job as management editor at *BusinessWeek*. He invited me to Estes Park, Colo., where he and his wife, Doris, often spent summers in a log cabin, part of a YWCA camp. I remember him counseling me to drink lots of water, ingest a super dose of vitamin C, and take it easy to adjust to the high altitude. I spent two days getting to know Drucker and his work. We had breakfast, lunch, an dinner together. We hiked th trails of the camp. And I becam intimately familiar with his re markable story.

Born in Austria in 1909 into highly educated profession family, he seemed destined fo some kind of greatness. The V enna that Drucker knew ha been a cultural and econom hub, and his parents were in th thick of it. Sigmund Freud at lunch at the same cooperativ restaurant as the Druckers an vacationed near the same Alpin lake. When Drucker first me Freud at the age of eight, his fa ther told him: "Remember, toda you have just met the most im portant man in Austria and pe haps in Europe." Many evening his parents, Adolph and Caroline would gather the intellectua elite in the drawing room of the Vienna home for wide-rangin discussions of medicine, politic or music. Peter absorbed no merely their content but worldl ness and a style of expression.

When Hitler organized hi first Nazi meeting in Berlin i 1927, Drucker, raised a Protes tant, was in Germany, studyin law at the University of Frank furt. He attended classes taught by Keynes and Joseph Schum peter. As a student, a clerk in a Hamburg export firm, and a se curities analyst in a Frankfurt merchant bank, he lived throug the years of Hitler's emergence, recognizing early the menac of centralized power. When his essay on Friedrich Julius Stah a leading German conservative philosopher, was published a a pamphlet in 1933, it so offended the Nazis that the pamphle was banned and burned. A second Drucker pamphlet, *Die Ju*

WHY DRUCKER STILL MATTERS

A few of the many timeless ideas drawn from his work

ON LEADERSHIP Don't ever think or say "I." Think and say "we." Effective leaders know they have authority only because they have the trust of the organization. They understand that the needs and opportunities of an organization come before their own needs.

ON TALENT Attracting and holding talent have become two of the central tasks of management. Knowledge workers have many options and should be treated and managed as volunteers. They're interested in personal achievement and personal responsibility. They expect continuous learning and training. They want respect and authority. Give it to them.

ON WORK Focus on opportunities rather than problems. Problem solving prevents damage, but exploiting opportunities produces results. Unless there is a true crisis, problems shouldn't even be discussed at management meetings until opportunities have been analyzed and dealt with. Exploit change as an opportunity, and don't view it as a threat.

ON MAKING DECISIONS Every decision is risky: It's a commitment of present resources to an uncertain and unknown future. Risks can be minimized if you know when a decision is necessary, how to clearly define a problem and tackle it directly, and that you'll have to make compromises in the end. You haven't made a decision until you've found a way to implement it.

ON ORGANIZATIONS Human beings tend to close out the outside. But effective organizations exist not to satisfy themselves but to fill a customer need. Leaders have the duty to focus an organization on the outside in a way that continually refreshes what everyone is doing inside the company.

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denfrage in Deutschland, or *The Jewish Question in Germany,* published four years later, suffered the same fate. The only surviving copy sits in a folder in the Austrian National Archives with a swastika stamped on it.

Drucker immigrated to London shortly after Hitler became Chancellor, taking a job as an economist at a London bank while continuing to write and to study economics. He came to America in 1937 as a correspondent for a group of British newspapers, along with his new wife, Doris, whom he had met in Frankfurt. "America was terribly exciting," remembered Drucker. "In Europe the only hope was to go back to 1913. In this country everyone looked forward."

So did Drucker. He taught part time at Sarah Lawrence College before joining the faculty at Bennington College in Vermont. He could be a difficult taskmaster. One Bennington student recalled that Drucker said her paper "resembled turnips sprinkled with parsley. I could wring his fat frog-like neck," she wrote in a letter to her parents. "Unfortunately, he is a very brilliant and famous man. He has at least taught me something."

Drucker was a professor of politics and philosophy at Bennington when he was given the opportunity to study General Motors in 1945, the first time he peeked inside the corporation. His examination led to the publication of his groundbreaking book, *Concept of the Corporation,* and his decision, in 1950, to attach himself to New York University's Graduate School of Business. It was around this time that Drucker heard Schumpeter, then at Harvard University, say: "I know that it is not enough to be remembered for books and theories. One does not make a difference unless it is a difference in people's lives."

"Drucker was a very elegantly trained thinker... as well as being a business editor [and] management consultant. It was the combination of all these talents that made him so remarkable"

—*Newt Gingrich*

CREATING A DISCIPLINE

HE TOOK SCHUMPETER'S ADVICE to heart, beginning a career in consulting while continuing his life as a teacher and writer. Drucker's most famous text, *The Practice of Management,* published in 1954, laid out the American corporation like a well-dissected frog in a college laboratory, with chapter headings such as "What is a Business?" and "Managing Growth." It became his first popular book about management, and its title was, in effect, a manifesto. He was saying that management was not a science or an art. It was a profession, like medicine or law. It was about getting the very best out of people. As he himself put it: "I wrote *The Practice of Management* because there was no book on management. I had been working for 10 yea consulting and teaching, an there simply was nothing or ve little. So I kind of sat down an wrote it, very conscious of the fa that I was laying the foundatio of a discipline."

Drucker taught at NYU for 2 years—and his executive classe became so popular that the were held in a nearby gy where the swimming pool wa drained and covered so hun dreds of folding chairs could b set up. Drucker moved to Cal fornia in 1971 to become a pro fessor of social sciences an management at Claremon Graduate School, as it wa known then. But he was alway thought to be an outsider— writer, not a scholar—who wa largely ignored by the busines schools. Tom Peters says h earned two advanced degree including a PhD in business without once studying Drucke or reading a single book writte by him. Even some of Drucker colleagues at NYU had fough against awarding him tenure be cause his ideas were not the re sult of rigorous academic re search. For years professors a the most elite business school said they didn't bother to rea Drucker because they found hir superficial. And in the years be fore Drucker's death even th dean of the Peter F. Drucke Graduate School of Management at Claremont said: "This is brand in decline."

In the 1980s he began to have grave doubts about busines and even capitalism itself. He no longer saw the corporation a an ideal space to create community. In fact, he saw nearly th opposite: a place where self-interest had triumphed over th egalitarian principles he long championed. In both his writing and speeches, Drucker emerged as one of Corporate America' most important critics. When conglomerates were the rage, h preached against reckless mergers and acquisitions. When ex ecutives were engaged in empire-building, he argued agains excess staff and the inefficiencies of numerous "assistants to." In a 1984 essay he persuasively argued that CEO pay had rock eted out of control and implored boards to hold CEO compen sation to no more than 20 times what the rank and file made What particularly enraged him was the tendency of corporat managers to reap massive earnings while firing thousands o their workers. "This is morally and socially unforgivable," wrote Drucker, "and we will pay a heavy price for it."

The hostile takeovers of the 1980s, a period that revisionist now say was essential to improve American efficiency and pro ductivity, was for Drucker "the final failure of corporate capital ism." He then likened Wall Street traders to "Balkan peasant

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stealing each other's sheep" or "pigs gorging themselves at the trough." He maintained that multi-million-dollar severance packages had perverted management's ability to look out for anything but itself. "When you have golden parachutes," he told one journalist, "you have created incentives for management to collude with the raiders." At one point, Drucker was so put off by American corporate values that he was moved to say that, "although I believe in the free market, I have serious reservations about capitalism."

We tend to think of Drucker as forever old, a gnomic and mysterious elder. At least I always did. His speech, always slow and measured, was forever accented in that commanding Viennese. His wisdom could not have come from anyone who was young. So it's easy to forget his dashing youth, his long devotion to one woman and their four children (until the end, Drucker still greeted his wife of 71 years with an effusive "Hello, my darling!"), or even his deliciously self-deprecating sense of play.

> "Business was just a starting point from which he had this platform to influence leaders of all different kinds"
> —*Rick Warren*

During his early consulting work with DLJ, the partners flew out to California to meet with Drucker at home. After one of his famously meandering monologues, Drucker thought everyone needed a break.

"Well, boys," he said, "why don't we relax for a few minutes? Let's go for a swim."

The executives explained that they hadn't brought their swimming trunks.

"You don't need swimming suits because it's just men here today," replied Drucker.

"And we took off our clothes and went skinny-dipping in his pool," recalls Charles Ellis, who was with the group.

Surely, Drucker never fit into the buttoned-down stereotype of a management consultant. He always favored bright colors: a bottle-green shirt, a knit tie, a royal blue jacket with a blue-on-blue shirt, or simply a woolen flannel shirt and tan trousers. Drucker always worked from a home office filled with books and classical records on shelves that groaned under their weight. He never had a secretary and usually handled the fax machine and answered the telephone himself—he was something of a phone addict, he admitted.

PRIVACY PREVAILS

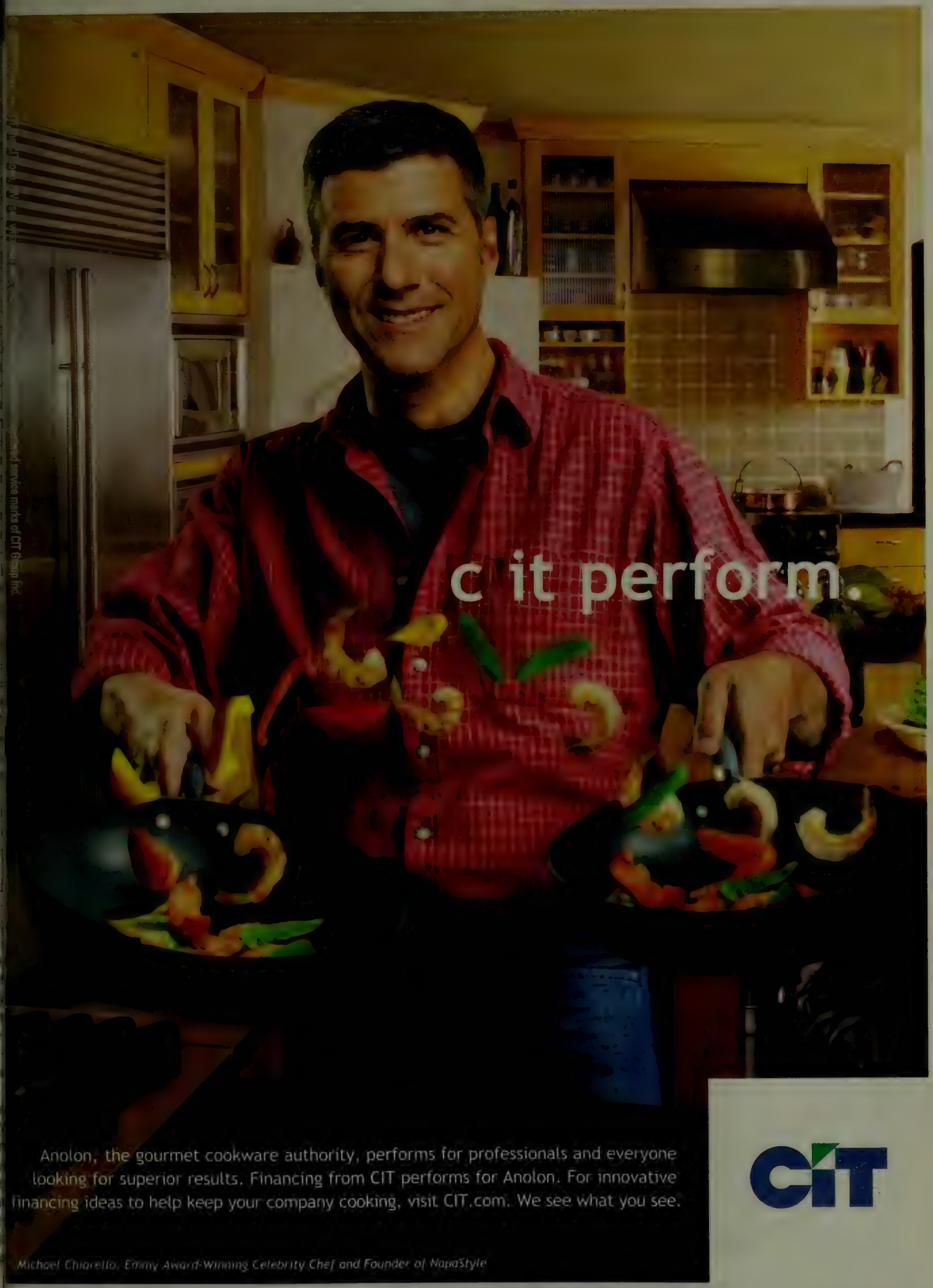
YET DRUCKER ALSO WAS an intensely private man, revealing little of his personal life, even in his own autobiography, *Adventures of a Bystander*, the book he told me was his favorite of them all. Not surprisingly, perhaps, the Drucker Archives at Claremont Graduate University contain only one personal letter from his wife to him. Doris had clipped two images from a 1950s-era newspaper, one of a handsome man in a plaid robe, fresh from a good night's slee another of a couple in love, ma and woman staring into eac other's eyes, over a late evenin snack. She glued each black-and white image onto a flimsy piece c typing paper and wrote th words: "I love you in the morn ing when things are kind of fran tic. I love you in the evenin when things are more romantic. It is undated and unsigned.

It was Doris, in her own un published memoir, who told th story of how she once locke Drucker in a London coal cella to hide him from her disapprov ing mother. As Doris' mothe turned the house upside down i a frantic search for a man sh thought was sleeping with he daughter, Peter spent the bette part of the night crouched in cold, dark hole. Doris' mothe had long hoped her daughte would someday marry a Roth schild or a German of high socia standing. The last thing sh wanted was for her to marry light-in-the-pocket Austrian.

In his later years, as his healt weakened, so did Drucker' magnetic pull. Although he maintained a coterie of corporat followers, he increasingly turned his attention to nonprof leaders, from Frances Hesselbein of the Girl Scouts of the US to Rick Warren, founding pastor of Saddleback Church in Lak Forest, Calif. Warren, author of *The Purpose-Driven Life*, con sidered Drucker a mentor. "Drucker told me: 'The function c management in a church is to make the church more church like, not more businesslike. It's to allow you to do what you mission is,'" Warren said. "Business was just a starting poin from which he had this platform to influence leaders of all dif ferent kinds."

Still, it was clear Drucker cared deeply about how he woul be remembered. He tried in 1990 to discredit and quash an ad miring biography of quality guru Deming, whom he seemed t consider a rival. And when Professor O'Toole assessed the in fluence of Drucker's landmark 1945 study on General Motors he concluded that the guru not only had had no impact on GM but also became persona non grata at the company for nearl half a century. "I sent it to Peter, and he spent hours going ove it with me," recalls O'Toole. "He was a little unhappy with it be cause he didn't like the conclusion. He felt he had had a big im pact at GM. I thought that was either very generous of Peter o else he was kidding himself."

During the same period, Drucker, then 80 years old, penned severely flawed foreword for a new edition of Alfred Sloan's *M Years with General Motors*. In one passage, Drucker quotes Sloa as saying that the death of his younger brother Raymond wa "the greatest personal tragedy in my life." Raymond, howeve died 17 years after Alfred. In another section, Drucker noted tha the publication of the book had been delayed because Sloan "re fused to publish as long as any of the GM people mentioned i the book was still alive. On the day of the death of the last livin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person mentioned in the book, Sloan released it for publication," wrote Drucker. In fact, Sloan generously heaped praise on 14 colleagues in the preface of his book, and all were still alive when *My Years with General Motors* was first published.

Whether the mistakes were a result of sloppiness or his declining intellectual power is not clear. But Drucker was no longer at the top of his game. The dean of the Drucker school, Cornelis de Kluyver, had reason to believe that Drucker's influence was on the wane—the school was having difficulty attracting big money from potential donors. To gain a $20 million gift for its puny endowment, de Kluyver agreed in 2003 to put another name on the school, that of Masatoshi Ito, the founder of Ito-Yokado Group, owner of 7-Eleven stores in Japan and North America. Students protested, even marching outside the dean's office toting placards decrying the change. An ailing Drucker volunteered to speak directly to the students. "I consider it quite likely that three years after my death my name will be of absolutely no advantage," he told them. "If you can get 10 million bucks by taking my name off, more power to you."

In April, during our last meeting, I asked Drucker what he had been up to lately. "Not very much," he replied. "I have bee putting things in order, slowly. I am reasonably sure that I a not going to write another book. I just don't have the energ My desk is a mess, and I can't find anything."

I almost felt guilty for having asked the question, so I praise his work, the 38 books, the countless essays and articles, th consulting gigs, his widespread influence on so many of th world's most celebrated leaders. But he was agitated, even dis missive, of much of his accomplishment.

"I did my best work early on—in the 1950s. Since then it marginal. O.K.? What else do you have?"

I pressed the nonagenarian for more reflection, more intro spection. "Look," he sighed, "I'm totally uninteresting. I'm writer, and writers don't have interesting lives. My books, m work, yes. That's different." ■

—With Lindsey Gerdes in New Yor

BusinessWeek online Download a podcast interview with Executive Editor John A. Byrne on Peter Drucker's legacy at www.businessweek.com/search/podcasting.htm

LESSONS FROM A STUDENT OF LIFE

BY JIM COLLINS

Peter F. Drucker once responded to a request to discuss his personal strategies for self-renewal with a teaching point about self-renewal: "One of the secrets of keeping young is not to give interviews but to stick to one's work—and that's what I'm doing. Sorry, I am not available." Earlier in his career, according to John J. Tarrant's biography *Drucker*, he responded to distracting requests with a preprinted postcard that read:

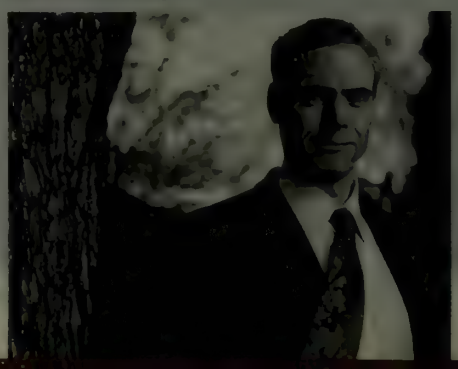
Mr. Peter F. Drucker appreciates your kind interest, but is unable to:
- **Contribute Articles or Forewords,**
- **Comment on Manuscripts or Books,**
- **Take part in Panels or Symposia,**
- **Join Committees or Boards of any kind,**
- **Answer Questionnaires,**
- **Give Interviews and,**
- **Appear on Radio or Television.**

Yet when asked to spend time with an unknown and unproven young man seeking his way in the world, Drucker freely gave the better part of a day to mentor and give guidance. I had the honor of writing about that day in the foreword to *The Daily Drucker*, wherein I recount how Drucker altered the trajectory of my life by framing our discussion around one simple question: "What do you want to contribute?"

And therein we find the secret to Peter Drucker: He had a remarkable ability not just to give the right answers, but more important, to ask the right questions—questions that would shift our entire frame of reference. Throughout his work runs a theme that highlights a fundamental shift, away from achievement—jettisoning with the flick of his hand, as if he were waving away an irritating gnat, any consideration of the question of what you can "get" in this world—to the question of contribution. Drucker's relentless discipline to say "no thank you" to invitations and inquiries stemmed from thinking always about how he could best contribute with his one lifetime.

That contribution was huge. Bob Buford, founder of the Leadership Network of churches, once suggested that Drucker contributed as much to the triumph of free society over tyranny as any other individual. For a free society to function we must have high-performing, autonomous institutions spread throughout. Without that, the only workable alternative is totalitarianism (as Drucker himself pointed out in his text *Management: Tasks, Responsibilities, Practices*). Strong institutions, in turn, depend directly on excellent management, and no individual contributed more to our understanding of effective management in the last 50 years than Peter Drucker. Winston Churchill saved the free world, but Peter Drucker showed us how to make that free world work.

COLLINS Drucker's simple question "What do you want to contribute?" was revelatory



Drucker never forgot his own teaching: Ask not what you can achieve but what you can contribute. If he had been granted another 95 years, I'm confident he would have continued to produce. At age 85, when asked which of his 26 books he was most proud of, he responded: "The next one." In intervening years he published at least eight more volumes, and at age 95, shortly before his death, he released yet another.

But for me, Drucker's most important lessons cannot be found in any text or lecture but in the example of his life. I made a personal pilgrimage to Claremont, Calif., in 1994 seeking wisdom from the greatest management thinker of our age, and I came away feeling that I'd met a compassionate and generous human being who—almost as a side benefit—was a prolific genius. We have lost not a guru on a pedestal but a beloved professor who welcomed students into his modest home for warm and stimulating conversation. Peter F. Drucker was driven not by the desire to say something but by the desire to learn something from every student he met—and that is why he became one of the most influential teachers most of us have ever known.

–Jim Collins is the best-selling author of Good to Great *and co-author of* Built to Last.

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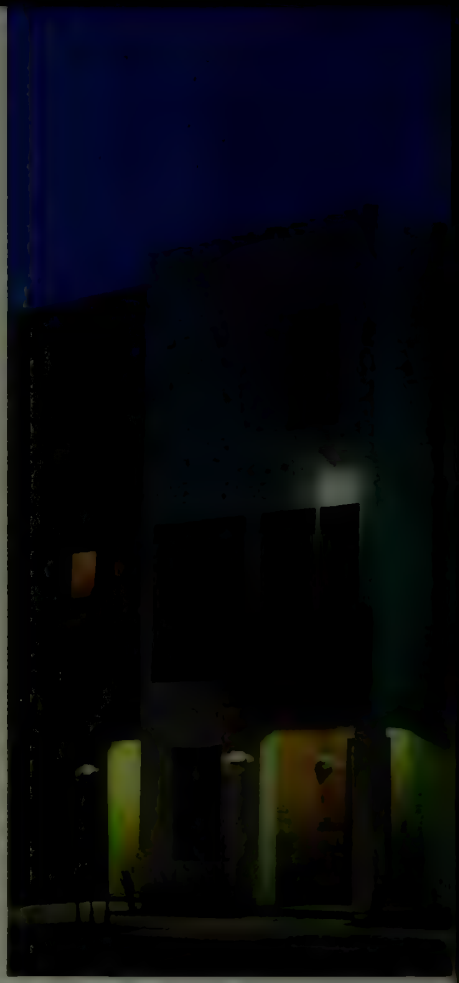
Home Is Where The Factory Is

The manufacturing bust has created some of the hottest properties around



BY JUSTIN HIBBARD

GAYLORD CONTAINER Corp.'s story is a familiar one in the age of offshoring. Undercut by foreign competition, the 80-year-old cardboard box maker sold out to Austin (Tex.) paper-packaging company Temple-Inland Inc. in 2002. But then this month, Temple-Inland sold Gaylord's 17-acre box plant in Antioch, Calif., for $6.5 million to real estate firm Fowler Property Acquisition LLC, which plans to get the land rezoned for residential use. A homebuilder has already offered Fowler $17 million for the land once it's rezoned. No wonder: The site is in one of the country's hottest housing markets, the San Francisco Bay Area.

The combination of the U.S. manufacturing bust and the housing boom has turned industrial plants into prized real estate. Many prime locations on city waterfronts and in downtown neighborhoods are occupied by factories that are closing left and right as competition from Asia drives jobs offshore and manufacturers out of business. But young professionals and empty nesters flocking back to inner cities have "made whatever scarce land is available in urban areas more attractive," says Christopher Jones, vice-president for research at New York's Regional Plan Assn.

Even as the national housing market cools, demand for homes in New York, Los Angeles, and other cities where land is scarce but empty factories are abundant will likely remain strong. "If you must accommodate over 70 million new people between now and mid-century, you're looking at a lot of demand," says Robert E. Lang, director of the Metropolitan Institute at Virginia Tech.

HOUSING WATCH

Much valuable real estate is languishing in the hands of private-equity firms. They frequently acquire underperforming manufacturers and close plants to reduce costs. With more than $500 billion in assets, the firms control as much as 15% of U.S. commercial real estate, according to John Troughton, senior broker at realtors Cushman & Wakefield Inc. "These firms are buying things on financial statistics, but they're ignoring the real estate," he says.

So far, buyers are doing better than sellers. Manufacturers are sometimes willing to part with an unused facility for a low price to escape a costly environmental cleanup and battles with city planners. But once new owners decontaminate a site and get it rezoned for housing, its value can skyrocket. In 1997 thermal underwear maker Indera Mills Co. shut its 97-year-old factory in downtown Winston-Salem, N.C. "A lot of our assembly jobs had gone to Mexico," says James Olson, treasurer and owner. Indera sold the plant the next year to local developers for about $1.5 million. One of the buyers, Beau Dancy, bought out his partners, got the land rezoned, and built 33 condos and three offices on the site just as a major effort to revitalize the city's downtown got under way. By 2003 he had sold all th units at prices from $120,000 t $750,000. Now he's building more acros the street. "We were probably 10 years to early" in selling, Olson says.

All the same, Indera made out all righ Because the plant was fully depreciate the company faced a stiff capital-gain charge. To avoid the bill, Indera used common strategy called a like-kind ex change, which allowed it to put mone from the sale toward a new distributio center in Yadkinville, N.C.—and avoi capital-gains taxes. It even saved mone by closing a leased facility in Winstor Salem and consolidating in Yadkinville.

Some developers are so eager to snatc up industrial sites that they will pay to dollar. "We go knocking on companie

FORE In ryville, Calif., ss the bay from Francisco

AFTER The City Limits project, one of the developments built by Pulte

loors and tell them: 'You may not know t, but your property has a significantly higher value if we are able to get residential entitlements on it,'" says Dan Flynn, vice-president of land acquisition at John Laing Homes, a Newport Beach (Calif.) developer. Laing has built homes where a lockmaker and truck depot once stood in Anaheim, Calif.

In a typical deal, a developer will offer to buy a site for what it's worth after rezoning and will put down a deposit—but not pay the rest until the city approves the rezoning. The developer makes its profit from the homes it builds. Telecom equipment maker DiCon Fiberoptics Inc. is in the middle of such a deal. With demand falling, DiCon decided to unload 12 surplus acres earmarked for expansion in Richmond, Calif. The company had paid $4 million for the land in 1998, but last summer builder Pulte Homes Inc. agreed to pay $14.4 million for it, subject to rezoning. "The price was significantly higher than what land would be valued at for research and development or light manufacturing," says Steve Kalmbach, a Pulte division president.

Why doesn't a company such as DiCon also ask for a cut of the profits from the homes? Some companies do discuss joint ventures with developers, but they're rare because companies without development expertise fear they'll find themselves out of their depth. "If they're a manufacturing or financial company, they should stick to what they do," says David Shannon, president at JDL Castle Corp., a developer in Winston-Salem.

Henrietta Development Corp. offered such an arrangement to Archer Daniels Midland Co. when it proposed buying ADM's old grain silo in Baltimore. "We always offer the possibility of a joint venture," says Patrick Turner, president of Baltimore-based Henrietta. But ADM declined the offer. "They concluded that it's not their core business, and they don't want to explain to stockholders if something goes wrong," he says. Henrietta wound up acquiring the 15-acre site for $6.5 million and building townhouses that sell for up to $700,000 in a partnership with Pulte.

UNEASY NEIGHBORS

MANY PRIVATE-EQUITY firms feel the same as ADM. "We prefer not to own real estate," says Robert Giles, a partner at SilkRoad Resources LLC, a Palo Alto (Calif.) private-equity firm. In September, SilkRoad and private-equity firm Triton Pacific Capital Partners LLC paid $4.75 million for the assets of Pilgrim Fireplace Equipment Co., a Fairfield (Calif.) maker of fireplace tools that had been struggling. The previous owner kept Pilgrim's most valuable asset: a plant in Fairfield valued at about $5 million.

Some businesses that don't need to close down plants are relocating them to cash in. In Emeryville, Calif., once a gritty city across the bay from San Francisco, property values have soared as factories have given way to condos and loft apartments. Pulte bought plants in the city from an equipment-rental business and a liquid-gas company, both of which then relocated to cheaper areas. "They both realized: 'I don't have to be at this location for my customer base,'" says Pulte's Kalmbach.

Not all cities are eager to rezone commercial land for residential use. Some officials worry that their tax base will suffer because businesses pay higher property taxes than residents. What's more, if homes start encroaching on factories, businesses may leave to avoid complaints about noise and fumes. "There's a constant tension between how much emphasis you put on redevelopment and how much on industrial," says Jones, of the Regional Plan Assn. Chicago, for example, has created six enterprise zones where residential building is prohibited. But as long as there are empty plants and eager home buyers, the factory-to-home conversion trend is here to stay. ■

Urban **Land Rush**

Developers are paying big bucks for industrial sites on which to build homes in land-starved cities

BUYER	PROPERTY	PRICE (MILLIONS)
Toll Brothers, Pinnacle	24-acre Maxwell House coffee plant on the Hudson River in Hoboken, N.J.	$76
Pulte Homes	8-acre fruit-packing plant in San Jose, Calif.	20
Pulte Homes	12-acre vacant site in Richmond, Calif., earmarked for a factory	14.4
Henrietta Development	16-acre glass manufacturing plant in Baltimore	6.8

Data: *BusinessWeek*, companies

Fighting Words for Time Warner

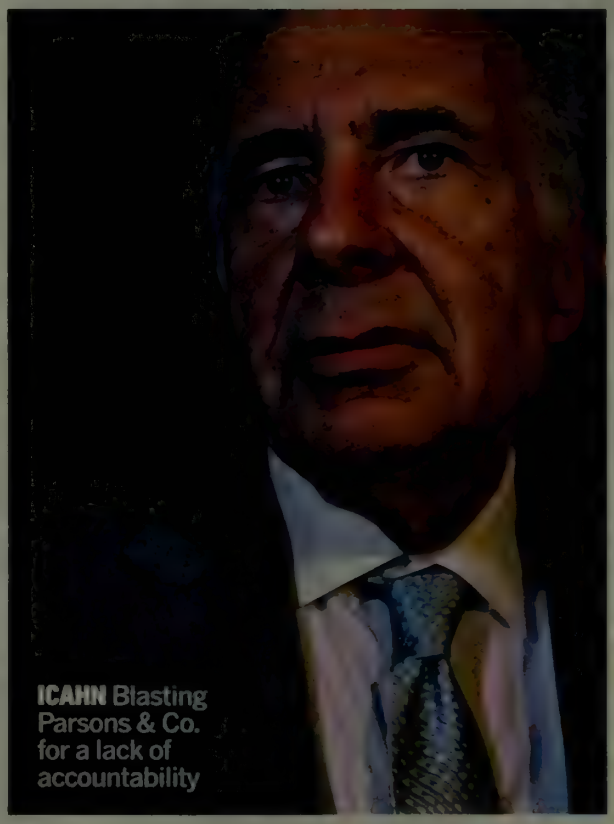
Carl Icahn on gambits to goose the stock—including a possible breakup

BILLIONAIRE FINANCIER CARL C. ICAHN became a legend after leading the fight to break up RJR Nabisco in the mid-1990s and pocketing some $1.3 billion. From 1996 through May, 2004, his stakes in 56 companies produced profits of $2.77 billion for an annual return of 53%, according to *Institutional Investor*. Now he has bought 2.5% of Time Warner Inc. and is pressing the media conglomerate for an overhaul to goose its stock price. Ensconced in offices on the 47th floor of the General Motors Building overlooking Manhattan's Central Park, Icahn, who rarely sits down for press interviews, spoke with *BusinessWeek* Senior Writer Gene G. Marcial on Nov. 14. Excerpts from their conversation follow:

What do you want Time Warner CEO Richard Parsons and the board to do?
They should break up the company by spinning off to shareholders the cable division—and possibly the publications—and run them independently. These properties are in great demand and, if traded alone, they would greatly enhance shareholder value. And Parsons should immediately do a $20 billion stock buyback to boost the stock's value.

Time Warner's next annual meeting is in May. What is your strategy?
We are forming a slate of proposed directors to replace some or all of the board through a proxy fight, which could include Parson's ouster. With the stock stagnant at between $17 and $18 a share, how can management say they are performing as they should? The stock would be even lower were it not for our entry.

Where should the stock price be?
If my plans were put in place, the stock would be worth more than $27 a share, based on the breakup value.



ICAHN Blasting Parsons & Co. for a lack of accountability

Why would that happen?
In breaking up Time Warner, the managers of the units would become unchained. They would be able to perform effectively and more profitably at much lower costs. Time Warner is a company that's bloated with an unnecessary bureaucracy at the very top.

What expertise do Parsons and the board have concerning AOL, publishing and the rest of content, and cable? Just look at their blunders over the past three years. Most of the people who pulled off the worst merger in American corporate history [the 2001 Time Warner-AOL deal] have not been fired. In fact, they are still running the show. Where is the accountability?

Parsons recently confirmed he'd be interested in selling a minority stake in AOL.
He's just had an epiphany about AOL. Where have they been for the past three years? I am concerned that Parsons and the board will make another error concerning AOL as they have done in selling Time Warner Music too cheaply.

You feel that the problems at Time Warner are not unique?
Many corporate chiefs are not qualified to run their companies. It's been that way for years. But they're not concerned about being ousted for weak performance because there is no accountability. Often, board member are cronies appointed by the very CEOs they are supposed to be watching. And they use the corporate treasury to keep themselves in power in the rare instances they are challenged in a proxy fight. The result is bloated bureaucracies. U.S. companies could easily cut costs by more than 30% and still operate profitably.

Does all this hurt anyone except shareholders?
Unless Corporate America wakes up to its problems, it will fall way behind the curve against its global competitors. More importantly, the country will not be able to meet the needs of future generations on such issues as social security, private pensions and health-care plans. Investor activism should be encouraged to push managements into productive action.

What's changed over your career as a corporate activist?
In my early days 25 years ago, CEOs would routinely sue me to deter me from waging such battles. They don't sue me anymore. Now they know I am not going away—and I usually win. ■

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E-Mail Is So Five Minutes Ago

It's being replaced by software that promotes real-time collaboration

BY MICHELLE CONLIN

DARREN LENNARD IS A managing director in the London offices of European-based investment bank Dresdner Kleinwort Wasserstein. Like many of the 21 traders he manages, Lennard is young (36), good-looking (Colin Farrell on Atkins), well-dressed (single-breasted bespoke), and cool (he rides to work on a silver, limited-edition Ducati). He also became something of a creative-class everyman a month ago when, after a long and onerous day at the office, he plucked his hyperactive BlackBerry from his silk-lined pocket and proceeded to smash it on the gleaming granite countertop of his London home.

As if an explanation is necessary. The analytically gifted investment banker had morphed into a zombie-faced thumb man, wheeling through his engorged inbox as his last activity before going to bed and his first upon waking. The time squandered on his electronic mistress made his brain reel. Of the 250 e-mails he received each day, he says "85% were totally not important to my job." Think that ratio of e-waste sounds depressing? It gets worse. Legitimate e-mail will drop to 8% this year, down from 12% last year, according to Redwood City (Calif.) e-mail filtering outfit Postini Inc.

BLOW-OFF FACTOR

WHAT MAKES LENNARD'S e-mail outburst unique is that it was embraced by his superiors. J.P. Rangaswami, Dresdner's global chief information officer, is among a growing group of experts dedicated to slaying the unwieldy electronic blob. The cc: button? "Cover your asses," says Rangaswami, sounding less like a suit than a tattooed text punk. "...And bcc:, that's, like, almost evil. People can hide and have these sneaky little private conversations. Ludicrous!"

Indeed, the onetime productivity wonder has turned into a maddening time waster. Despite the brawniest corporate filters, more than 60% of what swarms into corporate in-boxes is spam. Since so much of what's received involves scams about millions languishing in nonexistent bank accounts, interoffice status contests, and people plopping unwanted meetings onto Outlook calendars, the e-mail blow-off factor is rising. That's imperiling the medium's former dependability. In the long run, perhaps the biggest death knell for e-mail is the anthropological shift occurring among tomorrow's captains of industry, the text-messaging Netgens (16-to-24-year-olds), for whom e-mail is so "ovr," "dn," "w/e (over, done, whatever)."

No surprise, then, that on Rangaswami's orders, e-mail at Dresdner is beginning to fade as the collaboration tool of choice. Instead, workers there, as well as at places like Walt Disney, Eastman Kodak, Yahoo!, and even the U.S. military, are ditching e-mail in favor of other software tools that function as real-time virtual workspaces. Among them: private workplace wikis (searchable, archivable sites that allow a dedicated group of peo-

ple to comment on and edit one another's work in real time); blogs (chronicles of thoughts and interests); Instant Messenger (which enables users to see who is online and thus chat with them immediately rather than send an e-mail and wait for a response); RSS (really simple syndication, which lets people subscribe to the information they need); and more elaborate forms of groupware such as Microsoft Corp.'s SharePoint, which allows workers to create Web sites for teams' use on projects.

Though the likeliest scenario is that e-mail will remain the prime tool for notification and one-to-one communication, "a huge percentage of collaboration will occur outside of e-mail, with a continued rise in these other tools," says Clay Shirky, associate teacher in the interactive telecommunications program at New York University. "There's an enormous untapped value to be gotten by getting collaboration right."

Demoting E-mail

As spam swarms inboxes... ...employees are migrating toward other workplace communication tools

	2003	2007
Spam as a % of business e-mail*	60%	75%
E-mail	90%	75%
Instant messaging	8	15
Wikis and blogs	2	10

*U.S.-based organizations

Data: Gartner Inc.

KILLER WIKIS

ALTHOUGH ALL THESE tools are gaining momentum, it's easy-to-use and practically free wikis that proponents say offer the promise of collaboration beyond e-mail, even though big editing kinks remain and other quirks and security flaws are sure to surface. Internet research firm Gartner Group predicts that wikis will become mainstream collaboration tools in at least 50% of companies by 2009. At Ann Arbor (Mich.)-based Soar Technology Inc., an artificial-intelligence company that works on projects for the Office of Naval Research, wikis enable the company to slash in half the time it takes to complete projects. Soar engineer Jacob Crossman says that's because the wikis eliminate the usual flurry of back-and-forth attachments and resulting document-version confusion that's rife in e-mail. At Dresdner, Rangaswami says that among the earliest and most aggressive adopters, e-mail volume on related projects is down 75%; meeting times have been whacked in half.

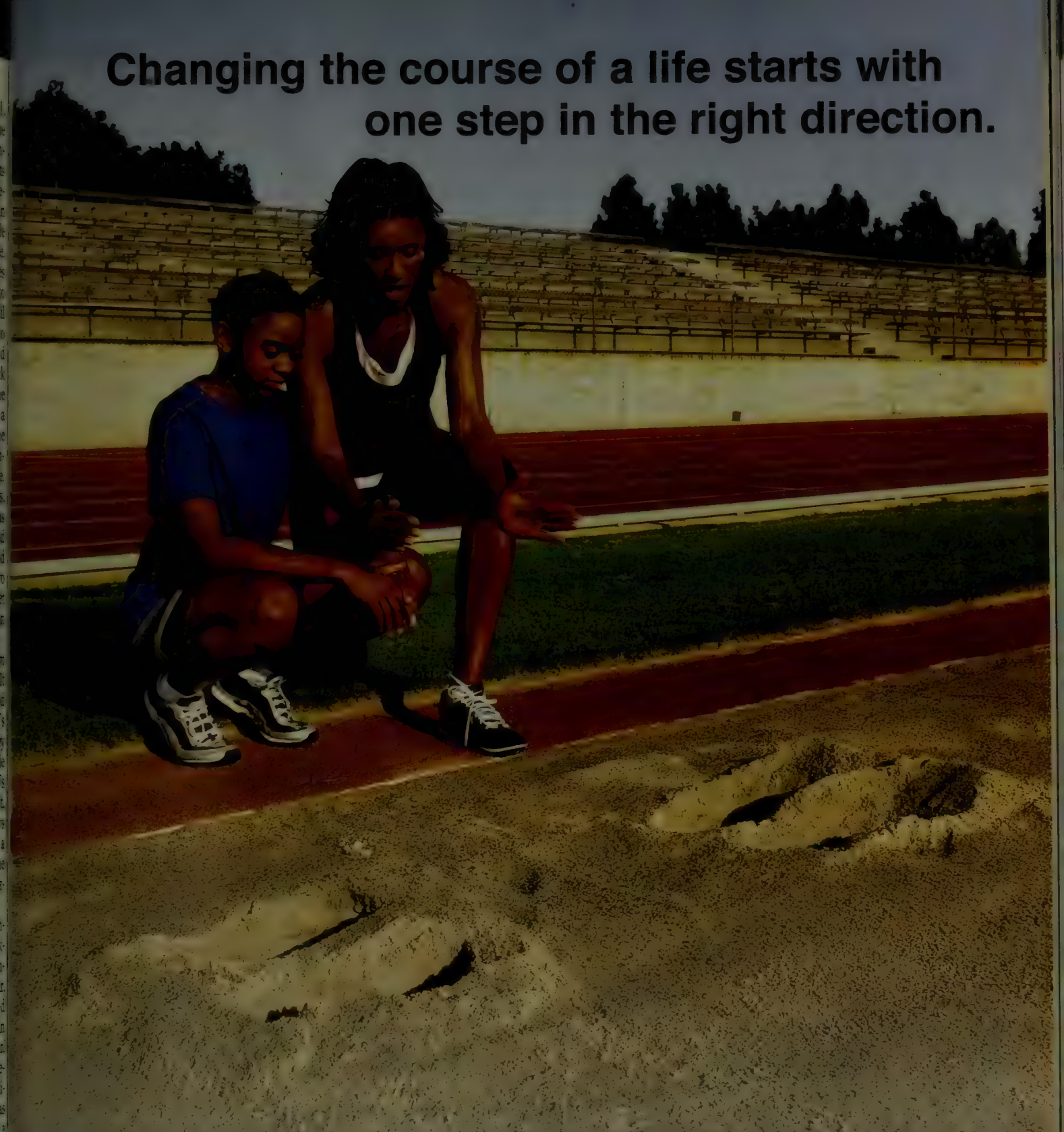
None of this is to imply, however, that e-mail is on its way to floppy disk-dom. It has certainly come under threat before. The Lotus Notes juggernaut of the early 1990s never displaced e-mail. Nor did attempts to build collaborative platforms during the boom. But this time may be different, Rangaswami and other experts say, because e-mail has hit a wall, creating an impenetrable scale of conversations people don't need to be a part of and shipping around mounds of information they can't possibly digest. What was intended as a point-to-point communication tool has been stretched into a broadcast medium.

That's what Darren Lennard is beginning to grasp at Dresdner. Instead of chatting via e-mail, Lennard now uses the bank's own version of Instant Messenger. Projects are also more efficient. Recently, Lennard wanted an analysis of how to double profits on a particular trade. Instead of shooting copies of the same document to several people via an e-mail attachment, only to have to keep track of, merge, and archive all the fixes back into a central version, he threw the problem up on a wiki page where everyone could brainstorm, comment, and edit in real time. In the space of two days, entire e-mail conversations evaporated and Lennard had analytics that would have otherwise taken two weeks. Next year's budget practically wrote itself on the wiki page.

Something very *Wisdom of Crowds* was happening. It was as if everyone could Google everyone else's brain. "The first thing they teach you at Harvard or Yale business school is that it's important to have efficient, open disclosure," says Lennard. "It's just that, as a team, we didn't have the tools to practice these amazing concepts until now."

This kind of open-source, bottom-up workplace is exactly what Rangaswami envisions. So far, companies have invested 95% of their spending in business processes, according to *Social Life of Information* author and former Xerox Corp. Palo Alto Research Center director John Seely Brown. A scant 5% has gone toward supporting ways to mine a corporation's human capital. That's why fans say the beyond-e-mail workplace will become a key competitive advantage. In the global race for innovation, it's not as much about leveraging what's inside your factories' machines as what's in your employees' heads. ■

BusinessWeek weekend For more on this story and to see how these wikis work, watch BusinessWeek Weekend. Check your local TV listings or go to businessweekweekend.com to view this and other stories



Six-time Olympic medal-winner Jackie Joyner-Kersee took a dream and made her mark in the world. Now, thanks to the Jackie Joyner-Kersee Foundation, a new generation of children is able to realize its own potential through education, athletics, and character building. Jackie Joyner-Kersee's signature "Winning in Life" program motivates young people and empowers them to take control of their future. Honda is honored to have been a supporter of Jackie Joyner-Kersee for more than 15 years, and we continue to salute her dedication and commitment. We also welcome and encourage others to get to know the important work her Foundation is doing to change the lives of children, one step at a time.

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HIRAKAWA "Before joining P&G, we were pretty arrogant"

Pets Are People, Too, You Know

At least, P&G's Iams treats them that way, fitting human products to Fido's needs

BY DIANE BRADY

IN 2000, A. G. LAFLEY CAME TO the top job at Procter & Gamble Co. with dog food on his plate. P&G had paid $2.3 billion the year before to buy Iams Co., with its Iams and Eukanuba lines of pet food, and quickly took Iams from specialty shops and veterinarian offices into 25,000 retail outlets. Such distribution muscle has helped the unit double sales to $1.7 billion last year from $800 million in 1999.

But Iams' growth is about more than just distribution. It also illustrates how the innovation machine at P&G, which has tapped different divisions to jazz up Iams with technology designed for humans, can rev up sales. Soon after the acquisition, P&G created a tartar-control coating for all of its adult pet food, adapted from the polyphosphate technology used in its Crest toothpaste line. The company is extending that formula to treats early next year. And down the road, it is considering pet-oriented extensions for everything from the Swiffer sweeper to Febreze odor remover. P&G also is thinking about introducing a pet shampoo. The goal: to profit from a global trend toward treating pets as family members, with all the pampering and products required by that higher status. "There are great similarities between the mother-baby bond and the owner-pet bond," says Iams' President Jeffrey P. Ansell, who previously worked in P&G's Pampers division.

More important, perhaps, is the way in which P&G sparked a cultural revolution within the pet food division. Iams, which was founded in 1946, has morphed from a somewhat inward-looking animal nutrition company into one aimed at, as Lafley likes to say, delighting the customer. That means more emphasis on satisfying owners' demand for such pet treats as savory sauces in Sizzlin' Bacon and Country Style Chicken flavors to sprinkle on dog food, much like a cheese sauce a mother would use to spice up broccoli. "Before joining P&G, we were pretty arrogant," says Diane Hirakawa, Iams' senior vice-president for research and development. Nutrition was all that mattered. Nobody really cared if people wanted a little something to spoil their pet. "We would never ask the consumer anything."

P&G's innovations draw from the company's practice of conducting extensive consumer research through everything from focus groups to home visits. Among the findings were consumers' persistent concerns about dealing with cats of different weights in the same household. The fat ones would simply eat from the skinny ones' bowls if owners tried to cut back. That led to Multi-Cat, a dry food with Vitamin A and L-Carnitine to reduce fat in heavier cats—and high protein to help lean cats maintain muscle mass.

HAIRBALL BREAKTHROUGH

P&G, meanwhile, has found that creativity flows both ways. Iams' work in areas such as hairball control formulas sparked the interest of Metamucil executives, for example. They're using the research to better understand fiber's impact on everything from intestinal health to kidney disease. Iams' research in fatty acids helped staffers who developed a line of vitamins under the Olay skin-care brand.

Iams still faces tough rivals such as Nestlé's Purina and Wal-Mart's Ol' Roy private label brand. But it's now the nation's top pet food brand, by dollar sales, according to ACNielsen and Roper ASW, accounting for 9.9% of retail sales as of September, 2005, up from 5.7% in 1999. While insiders say Lafley remains more smitten with the potential of face peels than pet food, he clearly craves constant innovation at all brands. That has helped Iams move beyond its niche of nutritious kibbles. ■

–With Robert Berner in Chicago

SMILE, BOY P&G's adult pet food now has tartar-control coating, adapted from its Crest toothpaste

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Anatomy Of a Credit Score

More companies are looking at ratings—so managing them is crucial. **BY TODDI GUTNER**

DURING A SHOPPING spree a few months ago, I opened several retail credit-card accounts to take advantage of an immediate 10% discount on that day's purchases. Surely this familiar offer was risk-free as long as I paid my bills on time right? It wasn't until I reported this story that I found out my credit score could have been negatively affected by the spate of new accounts I opened in such a short time. I had no idea.

Many people are ignorant of what their credit score is, how they can hurt or help that score, and how it can be used against them. Some 49% of 1,013 consumers polled do not understand that credit scores measure credit risk, according to a 2005 survey by the Consumer Federation of America and Fair Isaac Corp., the company that created the most widely used credit score formula called FICO.

Lenders have used these scores for years to determine whether to grant you a

loan and what interest rate you'll pay. "Credit scores are very powerful predictors of consumers' future [bill-paying] performance," says Mike Fratantoni, a senior research director at the Mortgage Bankers Assn. But with the rise of technology that can automatically assess consumer creditworthiness while you wait, FICO scores are now requested by insurance companies, cell-phone providers, utilities, landlords, and even prospective employers. That's a reason to make managing your FICO score a priority.

But first, just what is a credit score? To come up with one, Fair Isaac uses 22 pieces of data collected from the three major credit bureaus (Equifax, Experian, and TransUnion) to calculate a credit score—300 is the lowest, 850 the highest. The final number is a composite that comes from individual ratings in five categories: payment history (35% of the rating); length of credit history (15%); new credit (10%); types of credit used (10%); and debt (30%). Income is not a factor. "A person can have a very high income and never pay their bills," said Craig Watts, public affairs manager for Fair Isaac.

Fair Isaac calculates a FICO score based on the data provided by each credit bureau. It's not uncommon to see up to a 50-point differential between ratings. The reason: Bureaus collect data at different times of the month, or one bureau may have inaccurate information.

The higher the score, the lower the risk you are to a creditor—and the less interest you'll pay. Only 13% of the population has FICO scores of 800 or above; the median is 723. There is no single cut-off for loans, and it varies from industry to industry. But generally borrowers with scores above 740 receive the best rates.

To see how a change in your FICO score affects how much you'll pay, consider this example (table). On a $350,000, 30-year fixed mortgage, you'll pay 6.24% in interest, or $2,153 a month if you score between 720 and 850. If your score drops to between 620 and 674, your interest rate jumps to 8.05%, and your monthly cost rises to $2,581. You will pay an additional $154,131 over the life of the loan, according to a calculator on myfico.com.

Higher Scores, Lower Rates

Lenders use FICO scores, three-digit numbers ranging from 300 to 850, to determine your creditworthiness. You have three FICO scores, one from each major credit bureau. Generally, the higher your FICO scores, the lower your interest rate. See how different FICO score ranges affect interest rates and monthly payments on a $350,000 30-year, fixed-rate mortgage:

FICO SCORE	ANNUAL PERCENTAGE RATE*	MONTHLY PAYMENT	TOTAL INTEREST
720-850	6.24%	$2,153	$424,984
700-719	6.37	2,181	435,252
675-699	6.90	2,306	480,005
620-674	8.05	2,581	579,115
560-619	8.53	2,699	621,601
500-559	9.29	2,889	690,134

*Rates as of Nov. 11 **Data:** Informa Research Services Inc., myfico.com

WATCH YOUR WORTHINESS

WANT A PEEK at your FICO scores? Many people think they can get their FICO scores from their credit reports. They can't—but it's still a good place to start. The Fair & Accurate Credit Transactions Act of 2003 entitles you to a free credit report from each major credit bureau once a year. I ordered my reports by telephone from annualcreditreport.com and received them all within 10 days. It's smart to request a report from a different agency every four months so you stagger the reports over a year. That way, if there's bad information in one, you'll spot it sooner.

When you request a free credit report, each bureau will offer to calculate a credit score for $6.95. Experian and TransUnion use proprietary formulas; Equifax uses FICO scores. Pass up these offers because the information is not as comprehensive as you'll get elsewhere, and lenders are less likely to look at these scores.

For the most detailed explanations on your FICO scores, go to myfico.com. A score from one credit bureau costs $14.95, all three are $44.85. It's useful to buy all three because large lenders either average the scores or take the middle one. You'll want to check your FICO scores once a year or several months before you apply for a loan.

The negative factors that bring your score down remain on your credit report for seven years and can adversely affect your FICO score. But lenders typically look back only in the past two years when they make credit decisions. One 30-day late payment shouldn't make a difference. Lenders look for trends.

I paid for three scores and anxiously waited while the computer calculated them on the spot. Within seconds, I was relieved (not to mention a bit proud) when 771, 751, and 738 popped up on my screen. Still, I wondered why I wasn't in the 800-plus range. To find out, I reviewed the various strategies credit experts recommend to raise FICO scores.

» Pay all bills on time. This is probably the most important factor in the FICO calculation. If you're consistently 30 days

HARRY CAMPBELL

overdue, your score can drop by as much as 100 points, depending on how long the account has been open and how long ago the late payment took place. To avoid late payments, consider automating your bill-paying process. I got high marks in this arena.

» Think twice before closing accounts. Lenders are looking for consumers with long credit histories that have been managed well. But because of the increase in identity theft, you don't want too many open accounts that you don't use. "Be judicious about the accounts you have," says Norm Magnuson, public affairs officer for the Consumer Data Industry Assn. In an effort to consolidate our finances, I canceled an American Express account I had for 20 years to become an authorized user on my husband's account. While I benefit from his 20-year credit history on that account, it was still a mistake to eliminate my own. I have a few cards in my name only, but the history isn't as long.

» Minimize credit-card applications. Bingo. That was cited as a problem on all three of my FICO scores. On average, a consumer has a total of 11 credit obligations, of which seven are credit cards and four are loans. I had 21, of which six had balances. Each time you apply for credit, a lender requests to view your report. This inquiry is noted and can reduce your overall score. Don't apply for unnecessary credit, and if you're in the market for a big-ticket item that requires a loan, avoid credit applications for 18 months prior to your purchase.

» Keep balances low. The FICO score evaluates your total balances in relation to your available credit. This is known as credit utilization. Credit cards that are "maxed out" can lower your score. Try to spend only 30% of your credit limit. If you have a $10,000 limit on one card, keep the balance near $3,000. My credit utilization was too high. It helps that I pay off my balances every month, but it is better to spread the spending.

While my FICO reports said that "most lenders would consider consumers in this score range as extremely low risk," the competitive spirit in me wants to get over the 800 mark. To that end, I recently refrained from signing up for a Target Stores credit card to get $10 off on a $100 purchase. ■

BusinessWeek weekend

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The Agony Of the Options

Or how a crash course on "bear put spreads" and "collars" left me humbled. BY ADRIENNE CARTER

I HAVE ALWAYS CONSIDERED myself a savvy investor. My father taught me about mutual funds at the age of 12, and I opened my first brokerage account when I was 20. But after spending two days learning to trade options, I was humbled.

As an investor, I understand the appeal of options. Options contracts, which give the right but not the obligation to buy or sell stocks, indexes, or other financial instruments at a specific price in return for paying a premium, can help hedge a portfolio or generate income in a market that's moving sideways. That, plus cheaper online commissions and improved trading technology, helps explain why the options market is booming. In October monthly options trading volume hit an all-time high of 155 million contracts, up nearly 44% from the previous year, according the Options Industry Council, a trade organization.

Using options can be hazardous to your portfolio's health if you don't know what you're doing. These days, you can get educated dozens of ways, from books and Web sites to classes and personal tutoring (table, page 120).

Upon the recommendation of an industry insider, I signed up for the two-day introductory course at Optionetics, designed to teach individuals how to trade options on their PC or via a broker. The Redwood City, Calif., financial education firm has been giving such seminars for over a decade. Since 1993, more than 50,000 people have attended its courses in major U.S. cities and abroad. Because I was reporting a story, I didn't pay the tuition, which typically runs around $4,000.

My 120 or so classmates at the Brooklyn (N.Y.) site in early November were a diverse group. I'd expected mainly re-

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CODE: MRCBWF

TDW3851

tirees and boomers, but there were younger students, too. Patrick Pasteur and Zachary Simmons, the 24-year-old owners of a social services agency in South Orange, N.J., decided to take the course after hearing about it at a Donald Trump real estate workshop. Pasteur had tried his hand unsuccessfully at options trading, and Simmons was hoping to enhance his portfolio.

My instructors, Ken Farber and Peter Achs, were lively lecturers. They peppered their talks with sarcastic banter and riffs on personal finance diva Suze Orman. They spent much of the first day on the basics, starting with the difference between a put (a contract giving you the right to sell shares at a preset price) and a call (a contract giving you the right to buy at a preset price). But we weren't starting from scratch, either. Even before the first class, we had to read three chapters of a textbook and watch a DVD.

REAL-TIME EXAMPLES

FROM THE BEGINNING, the instructors encouraged us to put our pens and pencils down and just listen. After all, the material was already in the three coursebooks and set of DVDs that students get. To drive home key concepts such as delta (a change in the option value based on a move in the underlying stock) and open interest (the number of outstanding contracts), the instructors projected the material on two 10-foot-high screens in the banquet hall-cum-classroom. The lectures, broken only by several 15-minute breaks and a lunch hour, were interactive. Farber and Achs used real-time options prices and called on students to answer their questions.

We had homework, too. After the first day, we had to construct three bull call spreads using the January '06 options on online DVD rental site Netflix. (A bull call spread is when you buy the call at one strike price, and sell a call on the same stock for a higher price. It's a lower risk strategy than just buying the call—but less rewarding if the stock zooms.)

The message throughout the course was clear: Keep your risk in check. The teachers outlined rules for setting up a trade. For calendar spreads, for example, we should use at-the-money options—those with a strike price closest to the current price on the stock. (In a calendar spread, you buy a longer term option and sell a shorter term option with the same strike price and the same stock). More important, they showed us how to exit a position. Under their system, investors shouldn't be greedy. If you double your money on a bull call spread, cash out.

I breezed through Day 1. I could put together a sophisticated trade like a bear put spread. I knew which put to buy and which one to sell and how to place that order with my broker. I even picked up some technical analysis—parsing stock price and volume movements—which made it possible to find trading opportunities in the market. So when I arrived on the second morning, I was confident I would pick up the day's lessons with the same ease. But learning to trade options is a bit like learning to speak a foreign language. As we moved on to more complex strategies, I started to get performance anxiety.

Optionetics doesn't pretend everyone will pick it up in two days. It offers a lifetime repeat policy, so students can retake the seminar as many times as they like. Retiree Ken Kasowitz, a former programmer, took his first Optionetics seminar in June, 2004. Since then the 64-year-old has attended the course more than 10 times. He even hit one in London whil on vacation. Says Kasowitz: "I alway learn something new."

Of course, you don't need a class t learn how to trade options. Gene Cox, 53-year-old systems administrator i Indiana, has never taken a workshop. H read every book he could find on th subject and hit Web sites such as tha of Schaeffer's Investment Researc (schaeffersresearch.com).

It's also a good idea to try paper trad ing before putting your own money a risk. My instructors, both of whom hav been trading for more than a decade, sa they often use demo programs to tes trading strategies or see where old one went wrong. I've recently opened a account at online broker OptionsXpres (optionsxpress.com), which has a pro gram that lets me trade virtually. With on line practice and perhaps a few mor times in the classroom, I might be read to try a complex trading ploy called iro condor for real. Maybe. ■

The ABCs of Options Trading

With the market booming, more investors are getting interested in options. Here are resources that can help a neophyte get started:

» COURSES

Optionetics Seminar | optionetics.com | $3,995

A two-day crash course on options trading that is held in major cities in the U.S. and abroad, the class covers everything from technical analysis to trading strategies such as collars and credit spreads. And if you don't get it the first time around, Optionetics allows students to retake the course for free for as many times as they need to.

INVESTools Basic Options Workshop | investools.com | $3,000

An intensive one-day class, the workshop builds off the financial education company's introduction-to-stocks course. The cost includes proprietary trading tools. (This course is also offered under the BusinessWeek Investor Education program.)

CBOE Options Institute | cboe.com | Free to $995

The Web site of the Chicago Board Options Exchange is rich with educational resources, including a free online tutorial and live Webcasts such as an upcoming one on common trading mistakes. Online classes are available for $50. The $995 two-day masters seminar that's held regularly in Chicago offers a chance to tour the exchange floor and meet with a market maker.

» BOOKS

Michael C. Thomsett, *Getting Started in Options*, 6th edition (Wiley & Sons, $19.95)

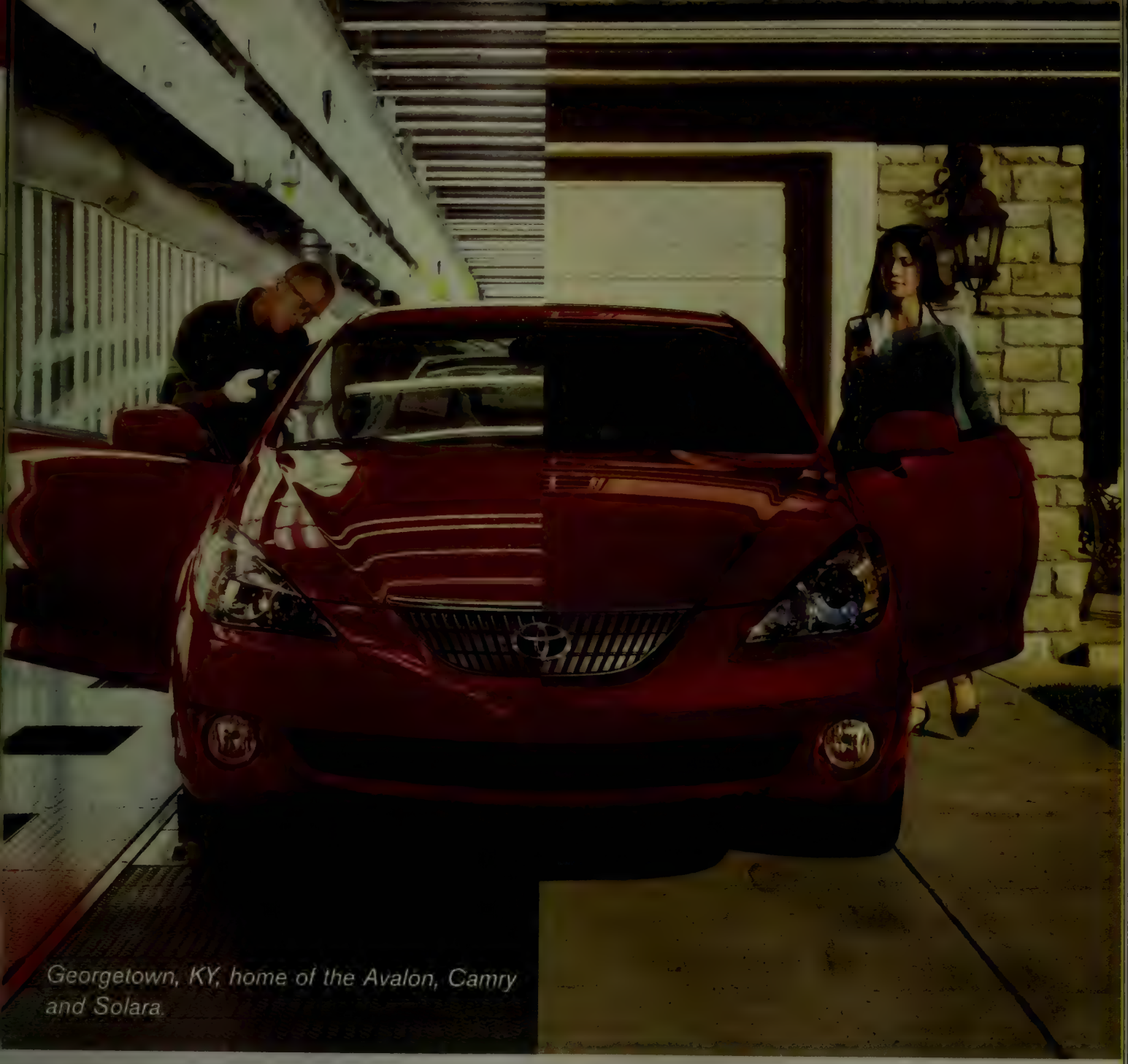
A basic guide to options, the book makes difficult concepts such as implied volatility easy to understand. Boxes highlight the key terms on that page.

Virginia B. Morris and Bess Newman, *An Investor's Guide to Trading Options*, 2004 edition (Lightbulb Press. $12.95)

This colorful work won't give you in-depth trading strategies, but it's a handy cheat sheet.

Characteristics and Risks of Standardized Options (Options Clearing Corp.) optionsclearing.com

This pamphlet is considered the prospectus on options. Although it's not a page-turner, it's a must-read for first-time options traders.



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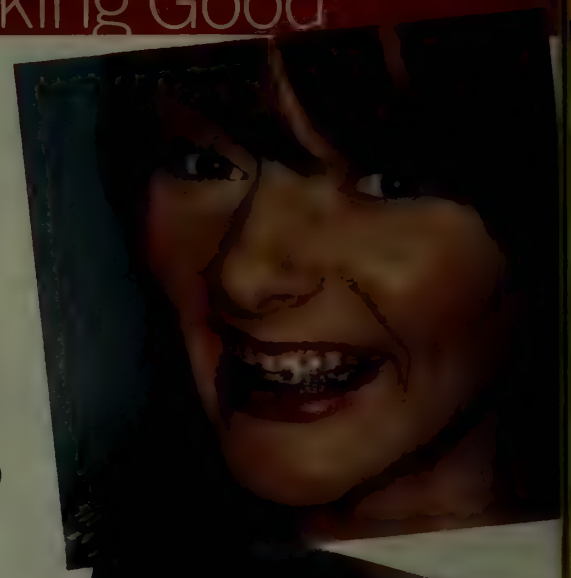
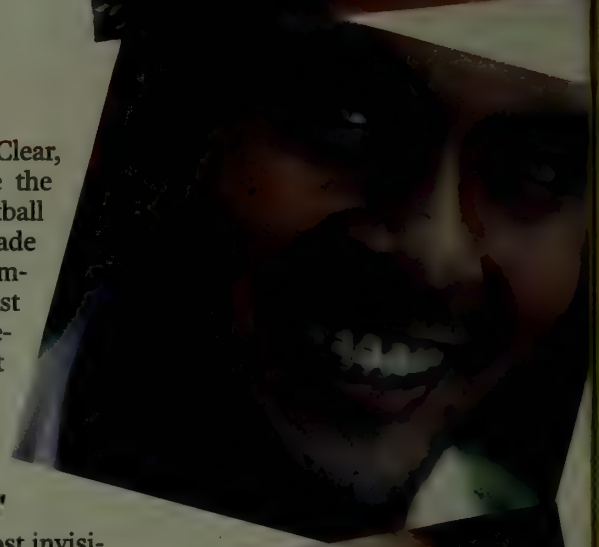
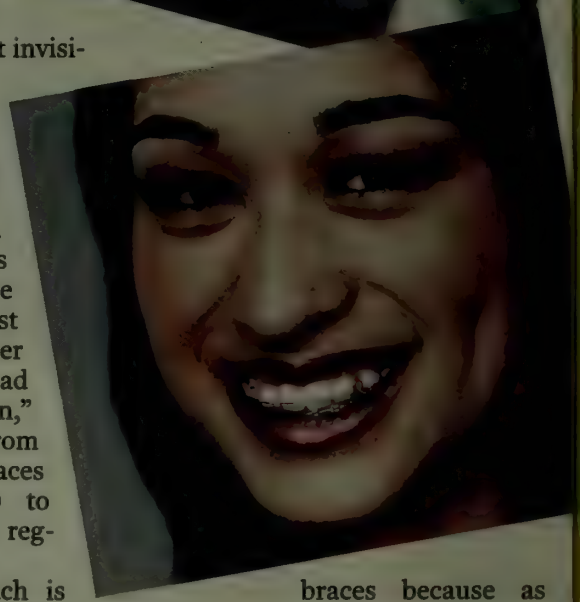
TOYOTA

Tinsel Teeth, Take Two

Need to refresh that smile? New braces can do it faster and with less pain. **BY KATE MURPHY**







YOU'D THINK THAT AFter suffering through braces as an adolescent, you'd have paid your dues. That the tradeoff for being mocked as a metal mouth during your formative years was knowing that when the wires came off, you'd have a perfect smile for life?

Well, guess what? Your teeth naturally shift as you age, and over time, speech, breathing, and chewing patterns can throw them out of alignment. Plus, teeth that have been corrected have a tendency to go back to where they were before. "It's only within the past few years that we've realized you should wear retainers every night for the rest of your life if you want your teeth to stay put," says Don Joondeph, associate professor of orthodontics at the University of Washington in Seattle.

Fortunately, if your adult vanity can't abide crooked teeth, fixing them—for the first or even the second time—is easier than you might think. Recent advances have made the apparatus used to straighten teeth less painful to wear and less noticeable to others—not to mention more efficient, which means significantly shorter treatment times than in years past.

You can get a retainer made for about $60 to nudge teeth that are just slightly out of place. But if your teeth are more significantly misaligned, you're probably going to need braces. An option that's been available for about three years is removable appliances, such as the ones marketed under the names Invisalign, OrthoClear, and Orthotain. They look like the clear plastic mouth guards football players wear and are custom-made by the manufacturers based on impressions your orthodontist makes of your teeth. You get a series of aligners and wear each at least 22 hours per day for two to three weeks before graduating to the next one.

> "Your teeth naturally shift as you age," causing crowding and overbites

"PERFECT LITTLE SOLDIERS"

REMOVABLE BRACES are almost invisible and you can take them out to eat and brush your teeth. The downside is they can only move teeth horizontally. They won't work if your teeth turn in or out or are uneven vertically. Jennifer Davy, for example, was not a candidate for a removable appliance when she got braces last April at the age of 42. Many of her teeth were rotated and she had "this bucktooth thing going on," said the substitute teacher from Frederick, Md. Removable braces generally cost about $5,000 to $7,000, or about 25% more than regular metal braces.

Another orthodontic approach is lingual braces, which are affixed to the back rather than the front of your teeth, and cost about $10,000. This involves molding a gold alloy to the inside of your teeth. Jim Singh, a 28-year-old software product manager in Austin, Tex., says he has had lingual braces for nine months and contrary to his fears, "they don't affect my speech at all." He decided to get lingual braces because as young, single male, he didn't want hi orthodontia to show. A clear, removabl appliance wasn't an option because h needed to correct an underbite that wa affecting his ability to chew.

While regular metal braces are not a cosmetically appealing as removabl and lingual braces, they often straighte teeth faster and with more precisio thanks to recent advances in design an materials. Jeryl English, chairman of th orthodontics department at the Unive sity of Texas Dental Branch at Houstor

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ENERGY EXPERTS

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says brackets now have openings that shut and latch over wires like closing and locking a window. "There's much less friction than with the rubber bands we used to use to hold the wires in place," he says. Called self-ligating braces, they've been available for only about three years so not all orthodontists use them. But "they are so much better that soon everyone will offer them," Dr. English says.

Another improvement: nickel titanium wires. Dr. English says unlike older, more rigid stainless steel wires, nickel titanium wires have "shape memory." That means they gradually go back to their original form, bringing the teeth along with them. As a result, patients see results faster and only have to go to the orthodontist for an adjustment every two months rather than every month for steel wires. Indeed, after just five months of a projected 18 months of wearing brace Davy—who has nickel titanium wires- says "my teeth are now lined up like pe fect little soldiers." It will take more tim to correct her overbite, however.

The entire course of treatment will co Davy $5,000. She doesn't have dental i surance, and even if she did, most plar don't cover orthodontia for adults. But asked whether it's worth it, Davy's smi will tell all. ■

Podcasting

So You Want To Be an Internet Star

All you need is a script, a PC, and a short list of gear. **BY ANDREW PARK**

LE PODCAST Babolat's FrenchPodClass is a surprise success, with 10,000 listeners

SEBASTIEN BABOLAT WASN'T aiming for stardom in July when he started recording weekly French lessons from his living room in Monterey, Calif. He just wanted to try podcasting, a new way of distributing audio programs over the Internet, and thought a handful of people might want to brush up on their *bonjours* and *au revoirs*. But within a few months, his breezy and fun FrenchPodClass was attracting 10,000 listeners and ranking among the most popular podcasts around. Babolat, a 26-year-old student from Les Adrets, France, can't explain the free show's overnight success.

There's no mystery about why podcasting is hot. The technology allows anyone to produce a radio-style program that an audience can find, download, and listen to anytime. Podcasts aren't just for iPods; they can be heard on any computer or portable audio player. More than 10,000 of them have been posted on the Web, with topics ranging from politics and technology to vegan cooking and bass fishing. Apple gave podcasting a big boost when it began promoting the shows on its popular iTunes online music store last summer.

The beauty of podcasting is its simplicity. A podcast is nothing more than a digital audio file with a special link that allows it to be delivered via the Web. Chances are, you've got all the tools to produce one on your desk already. Babolat recorded his first show on his aging Dell laptop using a cheap microphone and Audacity, a free audio program he downloaded from the Internet. A Web-based service called Liberated Syndication hosts his podcast for $10 a month. His only upgrade has been a $50 Sony ECM-S80 microphone.

Several companies are aiming to make podcasting even easier by putting all the basic tools into one package. A goo example is the Podcast Factory fro M-Audio, an Irwindale (Calif.) div sion of Avid Technology that usuall caters to music pros. In researchin the podcasting market, M-Audio foun that sound quality made a big differenc in the success or failure of a show. So fo $150, it bundles a decent dynamic micr phone; an external "interface" with co trols for input and output levels and jac for headphones, speakers, and instr ments; and copies of Audacity and Podi er, a program for publishing your po cast. A bonus: 2,000 professional-quali

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Tool Box

M-AUDIO'S PODCAST FACTORY
This kit bundles all the basic tools needed to create professional-sounding shows.

music clips you can use to begin or end your show or introduce segments.

If you have podcast dreams, plot out your show before getting started. First, listen to some popular podcasts to get an idea of how they're structured (table). Then, write a script that will let you move smoothly from sign-on to sign-off. Keep it short: Anything over 30 or 40 minutes is longer than most people will listen to.

Next you'll need to assemble your equipment. You could use your PC's built-in mike, but your listeners might think you're recording from the moon. So upgrade to a headset that combines a better quality microphone with comfortable headphones to let you monitor your voice level. Sennheiser's PC150, which can be purchased from online discounters for less than $35, gives you the added benefit of a noise-canceling mike, which will cut down on background clicks and pops.

Keep in mind that most PCs don't have the proper jacks for connecting pro audio gear. Marshall Electronics solves that problem by including adapters with its $150 Desktop Recording Kit that allow the better-sounding condenser microphone to plug into a PC or Mac. An inexpensive mixer like the $120 TAPCO lets you amplify and even out your voice (and your guests' voices) so they can be heard no matter what kind of device your podcast is playing on. "The No.1 mistake most podcasters make is they have the audio levels wrong," says Todd Cochrane, author of *Podcasting: The Do-It-Yourself Guide* (Wiley Publishing, $19.99).

YOUR HOST WITH THE MOST

BEFORE YOU START, you'll need one more thing: a program for recording, mixing, and editing your audio. Audacity works well for beginners, and you can't beat the price. If you have a recent Macintosh, you probably have a copy of GarageBand, a more sophisticated piece of audio software. The latest version is part of Apple's $79 iLife '05 Suite. Want to see your script roll before your eyes like a TelePrompTer? The $250 ePodcast Producer from Industrial Audio Software can do that and let you record Internet-based phone calls from guests or listeners, too.

Once you've recorded your show, export the audio file as an MP3, the preferred format for podcasts. Be sure to edit the ID3 tags that describe your audio file for listeners. Then upload it to a Web server. Your Net provider likely gives you space you could use, but if your podcast catches fire, it might strain the bandwidth and get you in trouble. A better option is OurMedia.org, which hosts your podcast and stores archived shows for free. If you have a blog, post a link there to let your readers know the podcast is ready.

The final step: Add the link, known as a feed, that transforms your MP3 file into a podcast. That allows your listeners to find your podcast and subscribe to it, which means each new episode will automatically be downloaded to their computers. Sites such as FeedBurner.com will help you do this for free if you have a blog, or, if you're using Podcast Factory or ePodcast Producer, just type in some basic information and they do the rest. Post the link at iTunes and other podcast directories. Pretty soon, you may be a star. ■

Podcasting Do's and Don'ts

Podcasting is easy, but if you don't do it right, your listeners will tune out. Here are some tips:

DO
PLAN YOUR PODCAST and write a script before starting to record
CHECK THE SOUND QUALITY on different listening devices before posting your show
TEST YOUR SHOW with "feed validator" software or Web site to make sure your podcast is iTunes-friendly
DON'T
PLAY COPYRIGHTED music during your podcast without permission
HOST YOUR SHOW with an ISP that limits the available bandwidth
FORGET TO DESIGN an eye-catching logo that will draw listeners

Podcast Picks

Before recording your own podcast, take the time to listen to a few well-produced examples. Some of the best and most popular ones are hosted by independent and amateur podcasters. Here are a few:

ANCESTOR PODIOBOOK
project-daemon.net
Novelist Scott Sigler serializes his latest sci-fi thriller in free weekly podcast

THE BITTEREST PILL
danklass.com
Stay-at-home dad and former stand-up comedian Dan Klass riffs openly and humorously about his life in L.A.

43 FOLDERS
43folders.com
Quirky show devoted to ideas for making life and computing simpler, hosted by self-described "electronic hobo"

THE FRENCHPODCLASS
frenchpodclass.com
A weekly language lesson that smoothly incorporates music and conversation with grammar and vocabulary

GRAPERADIO
graperadio.com
Three wine enthusiasts discuss their passion and interview winemakers and other people from the industry

PODFINDER
Podfinder.podshow.com
Former MTV VJ Adam Curry goes looking for the best podcasts so you don't have to

REITTALK
Reitcafe.com
Interviews with executives who run real estate investment trusts and the people who invest in them

THIS WEEK IN TECH
thisweekintech.com
A weekly roundup of geek news, hosted by well-known technology journalist and prolific podcaster Leo Laporte

TRAVEL WITH RICK STEVES
podcasts.ricksteves.com/ricksteves.xml
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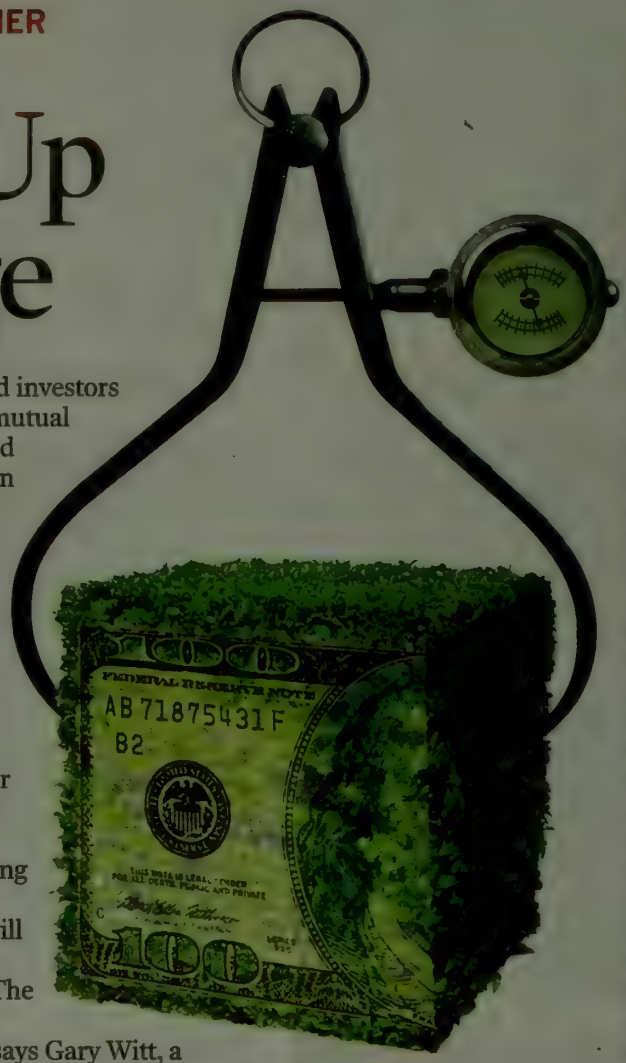
EDITED BY TODDI GUTNER

INVESTING

Sizing Up A Hedge



WITH HEDGE FUNDS booming—and investors worried about getting burned—mutual fund tracker **Morningstar** and bond rater **Moody's Investors Service** plan to launch hedge fund research tools next year and make them available to individual investors.

For an as-yet-undetermined fee, Morningstar plans to give individuals who qualify to invest in these partnerships access to a database—currently of 2,400 hedge funds—that it maintains for institutional clients. The data will be similar to what Morningstar supplies on mutual funds, including performance, fees, and risk.

Moody's, on the other hand, will scrutinize only those funds that request—and pay for—a rating. The firm will take a hard look at the "downside risk" of these funds, says Gary Witt, a managing director. In particular, it will size up the reputation of the funds' auditors, administrators, and prime brokers and will verify that those firms are indeed on the job. Moody's will also perform background checks on managers and assess the adequacy of the funds' policies in areas ripe for fraud, such as the pricing of illiquid holdings. The ratings will be free and available to the public, Witt says, although the research that went into them won't be. *–Anne Tergesen*

TIME OFF

CALL IT A REFRESHER COURSE in the oeuvre of Alfred Stieglitz. Missouri's Saint Louis Art Museum has selected 11 prints from the career of the American photographer, who lived from 1864 to 1946 and was married to painter Georgia O'Keeffe. Included are scenes of European rural life, views of New York industry and architecture (left, Rockefeller Center in 1935), and studies of clouds and landscapes near his summer home in Lake George, N.Y. The exhibition runs from Nov. 25 through Mar. 26 in the museum's Gallery 321 (slam.org). *–Monica Gagnier*

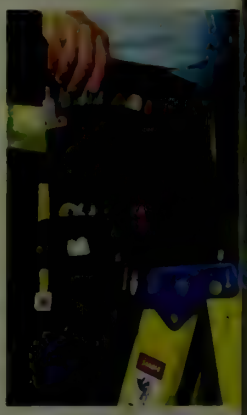
HEALTH CARE

A COMPASS FOR THE MEDICARE MAZE

SENIORS CAN FINALLY START to sign up for both the long-awaited Medicare drug program and for new Medicare managed-care plans. The enrollment period runs until next May, and it may take that long to sort through the options. In some states, seniors have to choose from more than 40 policies. Need some help in making a decision? For a good overview, check out the **Medicare Rights Center** site, medicarerights.org/drughelp.html. To see what kind of coverage may be best for you, try benefitscheckup.org, run by the **National Council on the Aging.** For details on specific plans, go to medicare.gov. Talk to your state's senior health insurance information program for specific info on plans in your state. You can find yours at eldercare.gov. Remember, you'll need to decide whether to sign up for a drug-only plan or a comprehensive managed-care plan that includes doctor and hospital care as well. *–Howard Gleckman*

GADGETS

A HOLSTER MADE OF NYLON



TOOL BELTS ARE handy for holding everything you need for home-repair or gardening projects. But bulky leather or canvas models can really weigh you down. The **Toolster Pro,** the lightest tool belt we've seen, is made from just six ounces of nylon and neoprene, and Velcro closings at both the waist and thigh keep it snug to your body. There's also a clever stick-on pocket that lets you carry small items, such as screws or plant spikes, only when you need them ($30 at toolsterbelts.com). *–Larry Armstrong*

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-2005125

BY GENE G. MARCIAL

CELL-PHONE CARRIERS PLANT MORE ANTENNAS ON SBA TOWERS.

LASERSCOPE'S FUTURE ISN'T AS GRIM AS SOME SELLERS THINK.

FALLING AD REVENUES MAY FORCE INTERPUBLIC TO SELL ASSETS.

SBA Towers Keep Rising

TWO YEARS AGO, when William Harnisch, CEO of hedge fund Peconic Partners, saw the explosion in the use of cellular telephones, he started buying shares—not of phone providers but of SBA Communications (SBAC). The company owns the towers where cell-phone carriers put up their antennas. Harnisch figures the tower companies will grow much faster than the wireless carriers. Since Harnisch bought SBA's shares, they have leaped from 4 to 16. "SBA, the smallest player in the tower industry—an integral part of the wireless providers' networks—is a long-term growth play," says Harnisch. Peconic now owns more than 3% of SBA. Harnisch thinks the stock is worth 27, based on the growth of its free cash flow and its rising earnings before interest, taxes, depreciation, and amortization (EBITDA). Although still in the red, results in its third quarter beat Wall Street forecasts, prompting some analysts to raise their estimates. Stronger-than-expected demand boosted tower site-leasing revenues, says Jonathan Atkins of RBC Capital Markets—which has done banking for SBA. He rates SBA "outperform," based on its order backlog and reduced capital expenditures. For site rentals, SBA gets a monthly fee of at least $1,800 per tower from the phone carriers, which usually sign contracts for five years or more. SBA also gets paid for related services. It owns 3,215 towers in the U.S., Puerto Rico, and the Virgin Islands. There are three "tenants" at each of the towers—which can accommodate up to six. Atkins figures SBA will post revenues of $160.7 million in 2005 and $181.3 million in 2006, and EBITDA of $93.4 million in 2005 and $111.1 million in 2006.

COMING IN LOUD AND CLEAR

Data: Bloomberg Financial Markets

Discover the e

This itsy bitsy Spider (SPY) goes a long way. In fact,
Spiders are an exchange traded fund (ETF), so they'
risks. Ask your advisor for details. Because the

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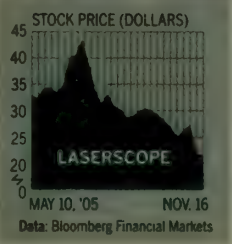
Take a New Look at Laserscope

SHARES OF LASERSCOPE (LSCP) got hit by a double whammy, plunging from 43 in July to 21 now. The maker of lasers to treat enlarged prostates posted disappointing third-quarter sales. What's more, Medicare cut reimbursement for prostate procedures. The laser is also used for cosmetic procedures. The drop has prompted buying by pros who felt the sell-off was overdone. "Laserscope is well on its way to becoming the standard of care in prostatic hyperplasia," says Keay Nakae of investment firm C.E. Unterberg Towbin, who rates the stock a buy, with a 12-month target of 31. Although sales are down from the previous quarter, year-over-year sales jumped 77%, he notes. Part of the sales drop was due to Hurricane Katrina, which disrupted business in the South. He sees earnings of $1.01 a share in 2005 and 96¢ in 2006 (when a higher tax rate kicks in). Patrick Winton of brokerage Sterne, Agee & Leach says the Medicare and other issues won't harm Laserscope's long-term performance. He tells his clients to buy.

TWO BAD BLOWS IN 2005



Data: Bloomberg Financial Markets

Will Interpublic's Woes Last?

AS ONE OF THE WORLD'S top ad agencies, Interpublic Group (IPG) counts top corporations as clients—Microsoft and Johnson & Johnson among them. But that hasn't stanched the bleeding at IPG, whose shares tumbled from 13 in June to 9 on Nov. 16. Three years ago they traded at 34. The agency is beset with accounting woes and falling revenues. While new management tries to turn things around, rumors swirl that IPC may have to sell assets. "That's one of two reasons we are buying in," says a New York hedge-fund manager. "The second is we see it as a long-term turnaround." James Peters of Standard & Poor's, who recently downgraded the stock from "buy" to "hold," says even if management turns things around, "margin growth will take longer than anticipated." It's possible, he adds, that assets may be sold, but not anytime soon. However, Stewart Barry of ThinkEquity Partners, who rates the stock "accumulate," says new CEO Michael Roth may be "more receptive to selling assets because his background is legal and financial rather than in advertising." Meanwhile, Barry has cut his 2005 revenue forecast from $6.3 billion to $5.9 billion, and EBITDA from $417 million to $13 million. He figures IPG will lose 74¢ a share in 2005. But IPG is cheap, he says, based on his EBITDA estimate for 2007 of $734 million, and profits of 52¢ a share, vs. his 2006 estimate of 5¢. An IPC spokesman says the best way to enhance shareholder value is to continue to improve financial controls and performance.

CHEAP—FOR A TURNAROUND

Data: Bloomberg Financial Markets

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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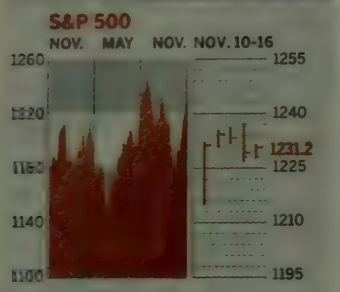
Personal Business Figures of the Week

STOCKS



COMMENTARY

Stocks traded in a tight range after jumping on Nov. 10. The action shifted to the Senate, where the Banking Committee signed off on Fed Chair nominee Ben Bernanke. Meanwhile, the bond market shaved 17 basis points off the 10-year Treasury note for the week and shares in Ford and GM hit new lows as the woes of the U.S. auto makers continued.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	NOV. 16	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1231.2	0.9	1.6	4.7
Dow Jones Industrials	10,674.8	1.2	-1.0	1.8
NASDAQ Composite	2197.9	0.6	0.6	5.3
S&P MidCap 400	716.9	0.5	8.1	13.8
S&P SmallCap 600	343.1	-0.6	4.3	9.6
DJ Wilshire 5000	12,283.9	0.7	2.8	6.6
SECTORS				
BusinessWeek 50*	744.1	1.4	5.6	9.3
BW Info Tech 100**	372.9	1.0	-0.1	4.5
S&P/BARRA Growth	591.2	1.2	1.6	3.9
S&P/BARRA Value	635.7	0.5	1.6	5.6
S&P Energy	367.4	0.3	27.3	31.7
S&P Financials	416.6	1.0	1.9	5.2
S&P REIT	150.2	1.7	4.0	7.4
S&P Transportation	237.6	0.0	-1.6	2.4
S&P Utilities	155.3	-1.3	9.7	11.3
GSTI Internet	201.1	4.5	12.8	24.3
PSE Technology	829.3	1.2	6.5	11.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	NOV. 16	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1414.3	0.1	1.2	8.7
London (FT-SE 100)	5430.0	-0.2	12.8	13.8
Paris (CAC 40)	4512.1	0.7	19.1	18.9
Frankfurt (DAX)	5081.5	1.4	19.4	23.4
Tokyo (NIKKEI 225)	14,170.9	0.7	23.3	27.0
Hong Kong (Hang Seng)	14,650.5	0.4	3.0	5.6
Toronto (S&P/TSX Composite)	10,727.0	0.7	16.0	19.8
Mexico City (IPC)	16,310.7	2.1	26.3	36.5

FUNDAMENTALS	NOV. 15	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.05%	2.06%	1.96%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.0	17.8	19.9
S&P 500 P/E Ratio (Next 12 mos.)*	14.7	14.5	16.5
First Call Earnings Revision*	-1.91%	-1.51%	-0.51%

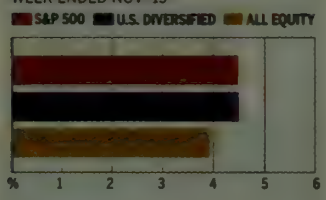
*First Call Corp.

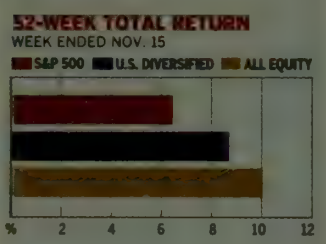
TECHNICAL INDICATORS	NOV. 15	WEEK AGO	READING
S&P 500 200-day average	1201.8	1200.5	Positive
Stocks above 200-day average	54.0%	52.0%	Neutral
Options: Put/call ratio	0.65	0.70	Neutral
Insiders: Vickers NYSE Sell/buy ratio	2.71	2.93	Negative

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Paper Products	22.6	Oil & Gas Refining	87.6
Fertilizers & Ag. Chems.	20.0	Fertilizers & Ag. Chems.	61.4
Internet Software	19.5	Managed Health Care	57.6
Home Furnishings	17.5	Oil & Gas Drilling	56.4
Employment Services	17.4	Oil & Gas Exploration	55.5

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Automobiles	-17.4	IT Consulting	-51.1
Commerical Printing	-9.2	Automobiles	-46.2
IT Consulting	-9.2	Photographic Products	-31.9
Building Products	-6.0	Auto Parts & Equip.	-27.2
Photographic Products	-5.1	Home Furnishings	-24.9

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Financial	7.6	Latin America	63.9
Latin America	7.6	Natural Resources	36.3
Technology	6.2	Diversified Emerg. Mkts.	31.6
Mid-cap Growth	5.5	Diversified Pacific/Asia	21.6
LAGGARDS		**LAGGARDS**	
Utilities	0.1	Precious Metals	3.5
Europe	1.1	Domestic Hybrid	5.3
International Hybrid	1.8	Miscellaneous	6.2
Pacific/Asia ex-Japan	1.8	Large-cap Blend	6.7

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Merrill Lynch Glbl. Val. B	15.3	T. Rowe Price Lat. Am.	71.2
ProFunds Internet Inv.	14.5	iShares S&P L. Am. 40 Idx.	68.0
Berkshire Focus	14.3	iShares MSCI Brazil Idx.	67.8
ProFunds UltraOTC Inv.	13.7	Merrill Lynch Lat. Am. C	66.1
LAGGARDS		**LAGGARDS**	
American Heritage Grth.	-20.0	Ameritor Investment	-60.9
Rydex Dyn. Vent. 100 H	-12.4	American Heritage Grth.	-42.9
ProFunds UltSh. OTC Inv.	-12.4	American Heritage	-27.3
American Heritage	-11.1	ProFds. USh. Mid Cap Inv.	-23.3

INTEREST RATES

KEY RATES	NOV. 16	WEEK AGO	YEAR AGO
Money Market Funds	3.51%	3.47%	1.68%
90-Day Treasury Bills	4.00	3.96	2.14
2-Year Treasury Notes	4.40	4.40	3.39
10-Year Treasury Notes	4.47	4.64	4.21
30-Year Treasury Bonds	4.66	4.84	4.90
30-Year Fixed Mortgage †	6.33	6.31	5.72

†BankRate, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	4.01%	4.63%
Taxable Equivalent	5.73	6.61
Insured Revenue Bonds	4.08	4.66
Taxable Equivalent	5.83	6.66

THE WEEK AHEAD

LEADING INDICATORS *Monday, Nov. 21, 10 a.m. EST* » The Conference Board's index of leading economic indicators is forecast to have risen 0.5% in October. That's the median forecast of economists polled by Action Economics. In September, the index dropped 0.7%, the third straight monthly decline.

FOMC MINUTES *Tuesday, Nov. 22, 2 p.m. EST* » The Federal Reserve's Open Market Committee releases the minutes of its Nov. 1 monetary policy meeting. The report will likely reinforce the consensus view that the Fed will keep raising interest rates through at least its Jan. 31, 2006, meeting.

INITIAL UNEMPLOYMENT CLAIMS *Wednesday, Nov. 23, 8:30 a.m. EST* » New filings for state unemployment claims probably stayed around 325,000 in the week ending Nov. 19, after hitting 326,000 for the week ended Nov. 5. After surging to 435,000 in late September, initial claims have gradually eased, indicating no lasting damage to the job market from hurricanes or energy prices.

CONSUMER SENTIMENT INDEX *Wednesday, Nov. 23, 10 a.m. EST* » The University of Michigan's final November consumer sentiment index is expected to be 79.9, unchanged from the early November reading, but up from 74.2 in October.

The *BusinessWeek* production index climbed to 260.6 for the week ended Nov. 5, a 12.9% gain from a year ago. Before calculation of the four-week moving average, the index rose to 263.2.

BusinessWeek online

For the BW50, more investment data, and the components of the production index, visit www.businessweek.com/extras

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'Om' in the Corner Office

RESONANT LEADERSHIP Renewing Yourself and Connecting with Others Through Mindfulness, Hope, and Compassion
By Richard Boyatzis and Annie McKee; Harvard Business School Press; 286pp; $25.95

Reuters Group Chairman Niall FitzGerald recalls a period when he became consumed with guilt and self-pity. Then a senior executive at Unilever PLC, he had launched a laundry soap so abrasive that it sometimes left clothes in tatters. His marriage was in shreds, too, largely because of his neglect of his family.

Friends who had supported FitzGerald in good times simply stopped calling. Then came a series of wake-up calls, including an emotional plea from a friend who was dying, urging the executive to pull his life together. FitzGerald began making the personal changes that ultimately helped him get beyond the debacle and reawaken his own zest for accomplishment. Today, with a new job, he runs marathons, raises money for charity, and strives to be an empathic and courageous leader. He's even in a stronger marriage—albeit with another woman. In short, he has achieved what authors Richard Boyatzis and Annie McKee call "resonant leadership."

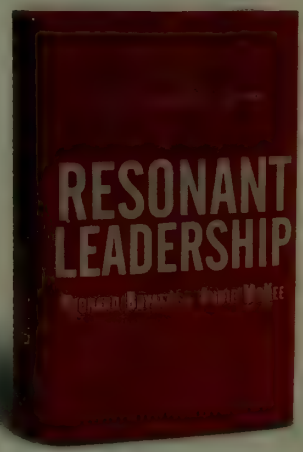
In their book of the same title, FitzGerald's story makes for one of the more compelling tales. *Primal Leadership: Learning to Lead With Emotional Intelligence, the* 2002 best-seller they wrote with Daniel Goleman, focused on the importance of the emotional aspects of leadership while showing readers how to be more engaged and effective at work. This one picks up where the last volume left off, reiterating the value of emotional intelligence.

What makes this account more than a simple clarion call for work-life balance are its fascinating if sometimes fawning profiles, as well as a simple framework for how to sustain inspired ways of working. Boyatzis and McKee look at how even great leaders can get trapped in what they call the "sacrifice syndrome"—becoming "mindlessly focused on getting things done" as stress mounts. The result is often a descent into "dissonance," losing touch with customers, employees, and family or close friends. Sometimes, it takes several wake-up calls to get torpid executives to change their situations and recharge their morale. Those who succeed tend to cultivate what the authors cite, with a bow to Buddhist philosophy, as the three main elements of resonant leadership—mindfulness (being in touch with your environment and yourself), hope, and compassion.

Group hugs all around, right? Some of the descriptions do veer a little close to New Age gobbledygook. But the stories keep the account rooted in reality. Besides FitzGerald, there's Roberto Nicastro of Italy's UniCredit Bancas, whose "ruffled hair, quick smile, and restless inclination to act make him appear to be in perpetual motion." Nicastro found that before he changed his ways, he was ruining his health and callously running over others. It's rare to hear executives so openly describe their emotions, and many readers will be touched.

Other examples are less interesting because they focus only on the positive. The authors laud Colleen Barrett, president of Southwest Airlines Co., for the positive climate she has helped to foster at that company. John Studzinski, a senior executive at HSBC PLC, is so accomplished at high-level volunteer work that he earned accolades from Pope John Paul II. A South African headmistress named Mrs. Zikhali (for some reason, they neglect to provide her first name) is hailed for her drive and vision in building a rural school.

Resonant leaders, say the authors, tend to strike an emotional chord in their work. They rally the troops, project excitement, and pursue tasks with passion. But sometimes they veer off track, a result of anything from a career setback to classic burnout. The fortunate ones take the time to figure out what matters to them and get back to living the life they want to lead. The unlucky continue to lose focus. They may be oblivious to others or find themselves surrounded by staffers who feel out-of-step with management. They have few habits conducive to well-being at work.



There are many exercises to help readers get in touch with what matters. Some of the drills, like one in which you describe your desired legacy, seem elementary. Others, such as a quiz to help clarify your values, may prompt worthwhile reflection.

Stories of execs who learn how to get in touch with what matters the most to them

In these high-stress, multitasking times, a book on the perils of mindlessly giving too much to the job is likely to find fans. What you do outside the office is just as important. That's one reason corporations from General Electric Co. on down have begun to put far more emphasis on social responsibility, saluting leaders who reach out to the communities in which they operate. Workaholics aren't just at risk for burnout. Increasingly, they're losing their places on the corporate ladder as well. ■

–By Diane Brady

BusinessWeek online For some sample exercises from *Resonant Leadership*, go to www.businessweek.com/extras

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IdeasViewpoint

BY ROBERT KUTTNER

The Trap of Inflation Targeting

Financial markets and economists across the spectrum breathed a sigh of relief when President George W. Bush named Ben S. Bernanke the new Federal Reserve chairman. Compared with other widely mentioned contenders, Bernanke is no ideologue but a well-respected academic economist with recent experience both on the Fed and the White House

Council of Economic Advisers. In fact, he is probably Bush's most mainstream major appointee.

Inflation hawks were especially pleased that Bernanke, to a far greater degree than Alan Greenspan, supports a policy known as inflation targeting. The idea is to fix monetary policy to a supposedly firm star—the desired rate of inflation. Bernanke has cited a target zone of 1% to 2%. In theory, this tactic becomes a virtuous, self-fulfilling prophecy: Financial markets, reassured that central bankers will act to keep inflation low, will not demand an inflation premium to lend money. These low interest rates, in turn, help damp down inflationary expectations.

UNFORTUNATELY, THERE ARE two big problems with the theory. First, it assumes inflation is controlled by central bankers or is substantially a reflection of expectations. But not all bouts of inflation are created equal. For example, if price increases are the consequence of external shocks such as sudden oil price hikes or currency crises—and not of macroeconomic "overheating" or market expectations—and the Fed responds mechanistically by tightening money according to a formula, it could drive a soft economy into full-blown recession.

Second, the Fed's most important short-term mission is to manage crises, such as the market crashes of 1987 and 2000-01. These spasms are seldom well correlated with inflationary trends. In both cases, the Greenspan Fed reacted vigorously by flooding the system with liquidity to keep a financial panic from causing a general depression. If the Fed slavishly kept to a rigid monetary rule based on targeting a set rate of inflation, it would tie its own hands in a crisis. Even Nobel laureate Milton Friedman, an advocate of a "strict monetary rule," doesn't favor that. Indeed, any central banker who failed to pursue a flexible policy in a crisis, as events warranted, would be a disaster.

Greenspan, though a conservative, moved away from strict monetary targeting or the related idea that inflation would be triggered if growth exceeded a "natural rate of unemployment." Why? Because, as a good empiricist, he noticed that a more productive economy could accommodate fuller employment and higher growth without inflation. It would be ironic—and unfortunate—if his nonideological successor returned the Fed to a monetary straitjacket.

Thankfully, in his Nov. 15 testimony to the Senate Banking Committee, Bernanke qualified his enthusiasm. Even earlier, while on the Fed from 2002-2005, he spoke of the risks of deflation. This became a handy smoke screen for him to support a loose monetary policy while still preserving his ostensible commitment to inflation targeting. In fact, the real inflation rate during the period stayed in positive territory, often above Bernanke's preferred target range. He also has fudged support for inflation targeting by inventing an oxymoron that he calls "contained discretion," a technical-sounding term for wiggle-room.

> It would be unfortunate if Bernanke returned the Fed to a monetary straitjacket

We should be grateful for this fudging because, in many ways, Bernanke faces a shakier economy than the one Greenspan inherited in 1987, notwithstanding the October stock market crash that was Greenspan's baptism by fire. Today's economy is menaced by unsustainable budget and trade deficits and escalating dependence on foreign borrowing to finance them. Many smart people, including former Fed Chairman Paul Volcker, believe it is only a matter of time before the dollar crashes, as foreign investors ultimately lose confidence and start selling dollar securities. The U.S. could avert this doomsday trajectory by running a more responsible fiscal policy and negotiating greater openness on the part of trading partners. But that major course correction is not the policy of the present administration and will take years to accomplish.

If a dollar crash did come, prices of imports would rise. Inflation would spike, while purchasing power fell. The Fed would be torn between raising rates to stem the dollar collapse and lowering them to keep the economy from imploding in a credit crunch. In such circumstances, inflation targeting would be useless and self-defeating as a concept or policy. ■

Robert Kuttner is *co-editor of* The American Prospect *(rkuttner@prospect.org).*

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Don't Be Lulled By Cheaper Gas

RETAIL GASOLINE prices in the U.S. fell for the sixth straight week in mid-November, dipping below $2.30 a gallon nationally for the first time since August. Under normal circumstances, such a steep decline in the cost of a vital commodity (down roughly 25% since September's peak) would be cause for celebration. Not now.

Indeed, hurricane season is almost over, but some key factors that contributed to America's recent sky-high energy prices—a lack of resolve about conservation, inadequate refining capacity, and fast-growing power demand in China and India—are still very much with us. So there's considerable danger that the current pricing respite could wrongly encourage U.S. consumers to revive spending on gas-guzzling sport-utility vehicles, turn up their thermostats a few degrees, and party like it's 1999.

That would be a big mistake, because those not-so-distant days of seemingly abundant energy at relatively cheap prices (in late 1999, gasoline was $1.28 a gallon) probably aren't coming back. There may be enough energy available to meet global needs for the next quarter-century, but we'll certainly have to pay up. In fact, the International Energy Agency (IEA) forecasts energy-producing nations will need to invest about $17 trillion over the next 25 years to meet a projected 50% jump in worldwide energy demand during that period. Since half that spending would be in developing countries, it's anybody's guess if all the needed investment will occur. If oil-exporting nations (consciously or unconsciously) underinvest in new capacity, shortages could send oil prices soaring. And because energy costs serve as a sort of tax on almost every commercial transaction, global growth likely would suffer as well.

Reliance on the volatile Mideast and North Africa for oil will only grow

But even if all that investment is made, we still might not like the consequences: The IEA predicts the share of global oil output from the volatile Mideast and North Africa would grow to 44% from about 35% today, because that's where the greatest opportunities to increase production lie. So much for "energy independence" for the U.S. and developed nations.

That's why policymakers and business must act while concern about energy security remains high enough to rally opinion behind meaningful conservation efforts (it's not just about buying a hybrid Prius, folks) or the need to allow new refineries to be built in someone's backyard, and the economy is strong enough to provide business with adequate capital to spend on energy-saving manufacturing processes and investment in alternative energy sources.

Such changes don't happen quickly. It took the federal government six years to reach the current level of generating 2.5% of its electric power from renewable sources like wind, solar, and biomass. (That's enough to power a city the size of El Paso for a year.) But the goal the feds announced this month to triple government's use of renewable sources by 2013 should be a wake-up call to private industry and average consumers that we must get serious about reducing our reliance on oil (much of it foreign) if "energy independence" is to be anything more than a flashy political catchphrase.

That's why it's best not to think of this year's high late-summer energy prices as the product of a short-term supply blip exacerbated by two freak hurricanes off the Gulf Coast. Instead, we should soberly remember those long, expensive months as a warning of what life could be like if we don't get serious about our energy future.

China's Budding Maturity

CHINA LAST WEEK mounted a surprisingly aggressive mobilization in hopes of averting an avian flu pandemic that has the potential to hobble Asia's economy and slam global growth (page 40). This is a far cry from Beijing's response to the 2003 outbreak of Severe Acute Respiratory Syndrome (SARS). Then, China restricted press coverage as it initially covered up a health crisis that left hundreds dead. Moreover, it caused many at home and abroad to question whether the Communist government's civil leadership would ever equal its economic prowess.

But today there are encouraging signs that China is maturing in how it views its responsibilities as a global leader. Its political leaders have continued opening markets to foreign competition (often against the wishes of powerful local interests), while becoming a bit more vigilant about protecting intellectual property—a major issue for foreign investors. Beijing's leadership in brokering the ongoing multilateral talks to encourage North Korea to dial back its nuclear ambitions has given China even more diplomatic legitimacy as a true power in the Asia-Pacific region. Now, Beijing's openness about bird flu takes that one step further.

To be sure, given China's famously opaque political system, it's always perilous to read too much into Beijing's shifts. And its leaders continue to curb internal political dissent. Still, China's emerging leadership in nascent world crises could have big implications for how the nation will address a range of pressing concerns, everything from its growing impact on the economies of trading partners to its long-standing dispute over the status of Taiwan. That certainly would be a positive development for China—and for global stability.

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BY ROBEN FARZAD AND BEN ELGIN (P. 60)

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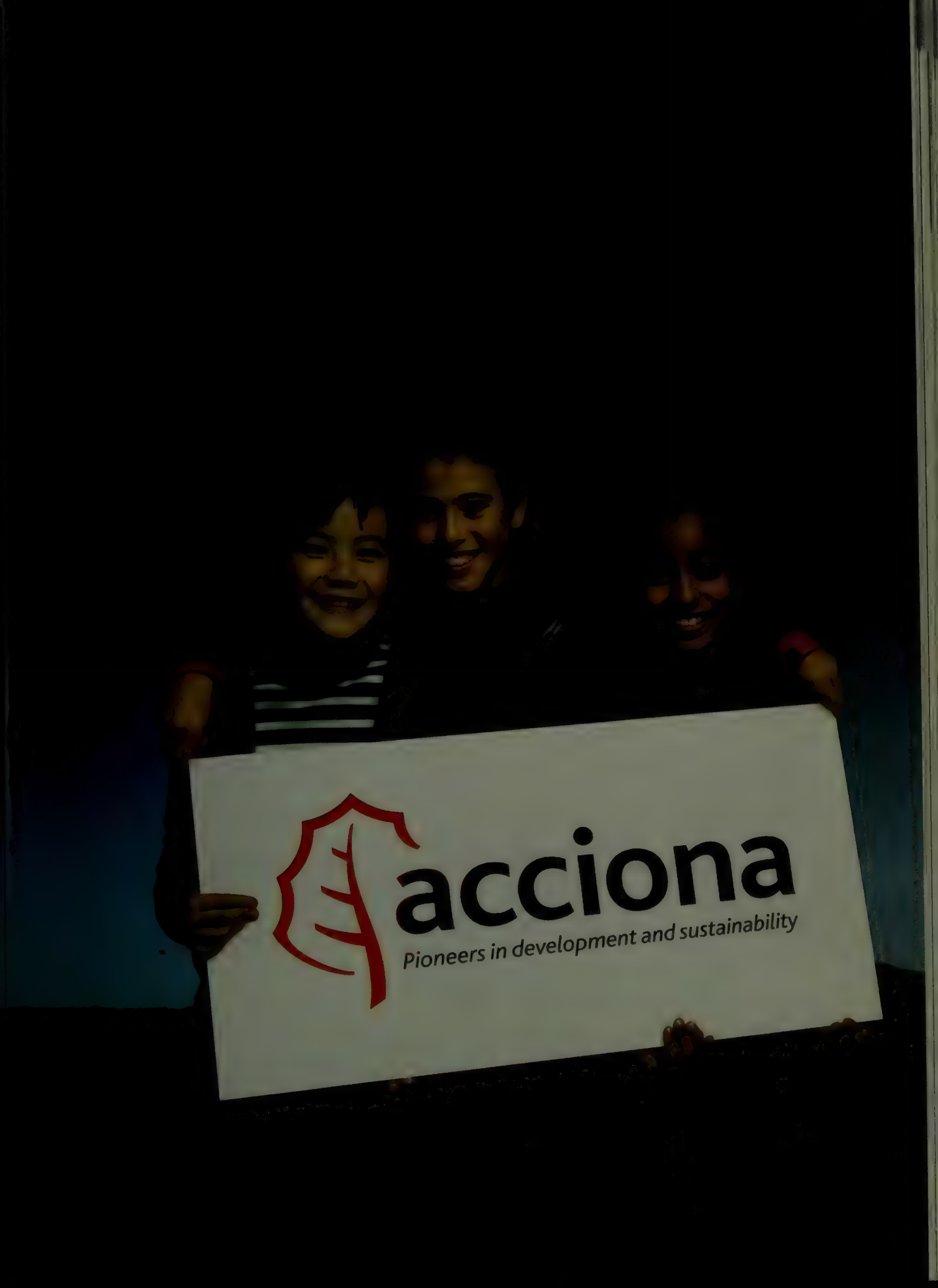
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Online Music's Elusive Bottom Line

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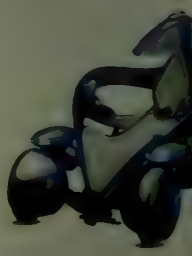

BusinessWeek's Chester Dawson test drives the electric-powered i-unit. This prototype boasts some impressive technology, but limited battery life and safety concerns make it less than streetworthy

A Shift in the Balance Of Wind Power?

European outfits have dominated the fast-growing industry. Here's an analysis of how the U.S., led by GE, may soon be changing that dynamic

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UP Front

"I wasn't brought up to run and hide when things get tough."

–General Motors CEO Rick Wagoner after announcing that GM will slash 30,000 jobs and close several facilities by 2008 to cut costs

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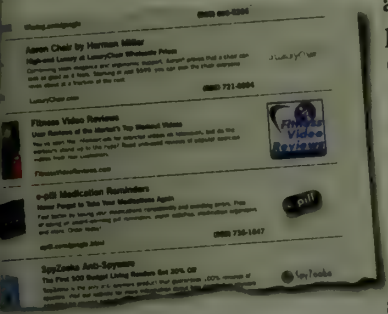


nd print, too. The first foray to "offline" media began in eptember, with Google uying ads in magazines ch as *Maximum PC*, *PC Iagazine*, and *Budget Living*. divvied up the space and resold it to a few of the several hundred thousand advertisers that buy keywords next to Google Web searches. Now, Google is about to greatly expand the program. Scores of additional magazines have signed up and will soon be promoted as an option for advertisers, say participating marketers.

Google hopes to serve as a nexus between advertisers, publishers, and customers, in all forms of media. The plan is to use its buying clout to negotiate prices and, by offering bite-size space, pull in a new breed of marketers that have avoided pricey print ads. That may prove difficult: Some early participants—from software makers to a debt-management company—were disappointed with the ads, which are bunched as many as seven to a page. Google says the program is new and it is working out the kinks.

–Ben Elgin

GAME CONSOLES

For Every Xbox, A Big Fat Loss

DESPITE ALL THE HYPE surrounding the new Xbox 360 video game console, **Microsoft** won't make money on the machine itself. A tear-down analysis by market researcher **iSuppli** of the high-end Xbox 360, which contains a hard drive, found that the materials cost Microsoft $470 before assembly. Chips alone account for 72% of that. The console sells at retail for $399, for a loss of $71 per unit. Other items in the box, such as the power supply, cables, and controllers, add $55 more to Microsoft's cost, pushing its loss per unit to $126.

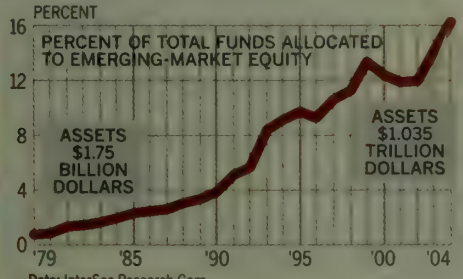
That's slightly higher than what Microsoft swallowed on the first Xbox console. ISuppli analyst Chris Crotty says efficiency gains eventually should shave $50 off chip costs, which, with other reductions over time, could get Microsoft closer to breakeven. A spokeswoman says Microsoft expects that including sales of its own game software, the Xbox line should start out "gross margin neutral"—breakeven—and turn a profit in 2007. Will this classic razor-and-blade strategy work? It hasn't so far: In the year ended on June 30, Microsoft's home entertainment division lost $391 million on sales of $3.3 billion.

–Arik Hesseldahl

(CLOCKWISE, FROM UPPER RIGHT) PHOTOGRAPH BY CHRIS PIZZELLO/REUTERS; CHART BY ERIC HOFFMANN/BW; PHOTOGRAPH BY VICTOR R. CAIVANO/AP/WIDE WORLD; GOOGLE AD EFFECTS BY DAVID RUDES/BW

THE BIG PICTURE

URED BY SWEET RETURNS, U.S. pension unds, foundations, and other traditionally onservative investors are shifting money nto emerging-market stocks.



Data: InterSec Research Corp.

UPFront

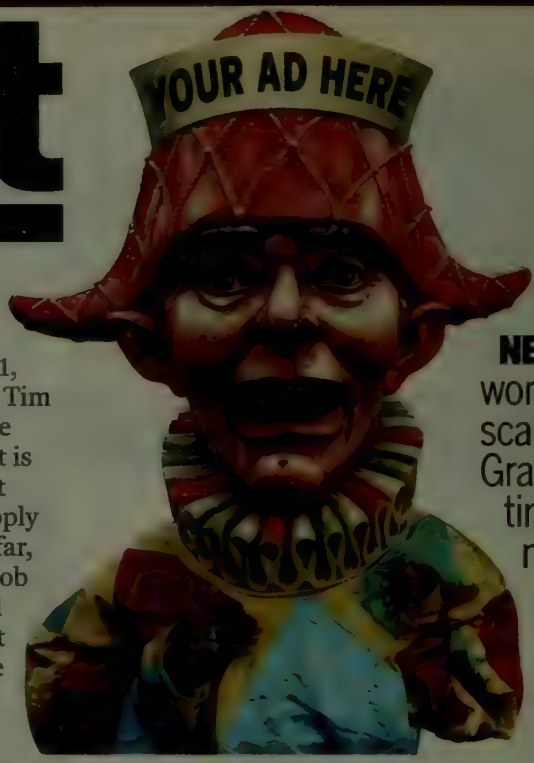
APPLE WATCH

A CHRISTMAS CRUNCH FOR iPOD LOVERS

DEMAND FOR APPLE'S IPOD will be huge again this holiday season, no question. The only issue is supply—and how much revenue **Apple** will forgo because of shortages that look unavoidable. **Circuit City Stores** says it expects shortages, and two smaller retailers say they're getting less than half of what they order each week. With demand expected to surge—analysts figure Apple could sell upwards of 10 million iPods in the final quarter—last-minute shoppers could be left with empty stockings.

Of most concern is the iPod Nano, which stores songs on scarce flash memory. On Oct. 11, Chief Operating Officer Tim Cook told analysts: "The demand for this product is staggering. At this point I can't project when supply will meet demand." So far, Apple is doing a better job of balancing supply and demand for itself than it is for its partners. While many stores don't have the hottest products, such as the black 4-gigabyte Nano, Apple is shipping all models within 24 hours from its online store. "It's frustrating at times" to work with Apple, says Charlie Tebele, president of retailer **RCS Experience**. "But as a businessman, I can only admire what they're able to get away with."

–Peter Burrows



POST-KATRI

NEW ORLEANS IS working to pull off a scaled-down Mardi Gras. And for the fi time in 150 years, may seek major corporate spon sorship. The C Council recent floated a plan cut the revelry i half, to six days, starting Feb. 23. The mayor's Mardi Gras Advisory Committee is receptive some corporate involvement, says Bill Grace, head of the committee. Bereft of funds and tourists, New Orleans may have no choice. Says Councilmember Eddie Sapir: "Where's t money going to come from?" Perhaps eyeing the cleanup angle, he suggested Mr. Clean, Tide, and Clorox for tie-ins. No word on wheth Slim-Fast can pick up the tab for Fat Tuesday.

–Coleman Cow

BLOGSPOTTING

FROM THE MOUTHS OF WONKS

becker-posner-blog.com

» **WHY READ IT:** To hear from Nobel laureate economist Gary Becker and federal appeals court judge Richard Posner. The free-marketeers post weekly on a single topic, from same-sex marriage to Katrina compensation.

» **POSTS:** Posner, on high gas prices preventing shortages: "The social benefits of... 'price gouging' appear to exceed the social costs by a large margin." Becker: "Countries should sell the right to immigrate...suppose the U.S. charges $50,000."

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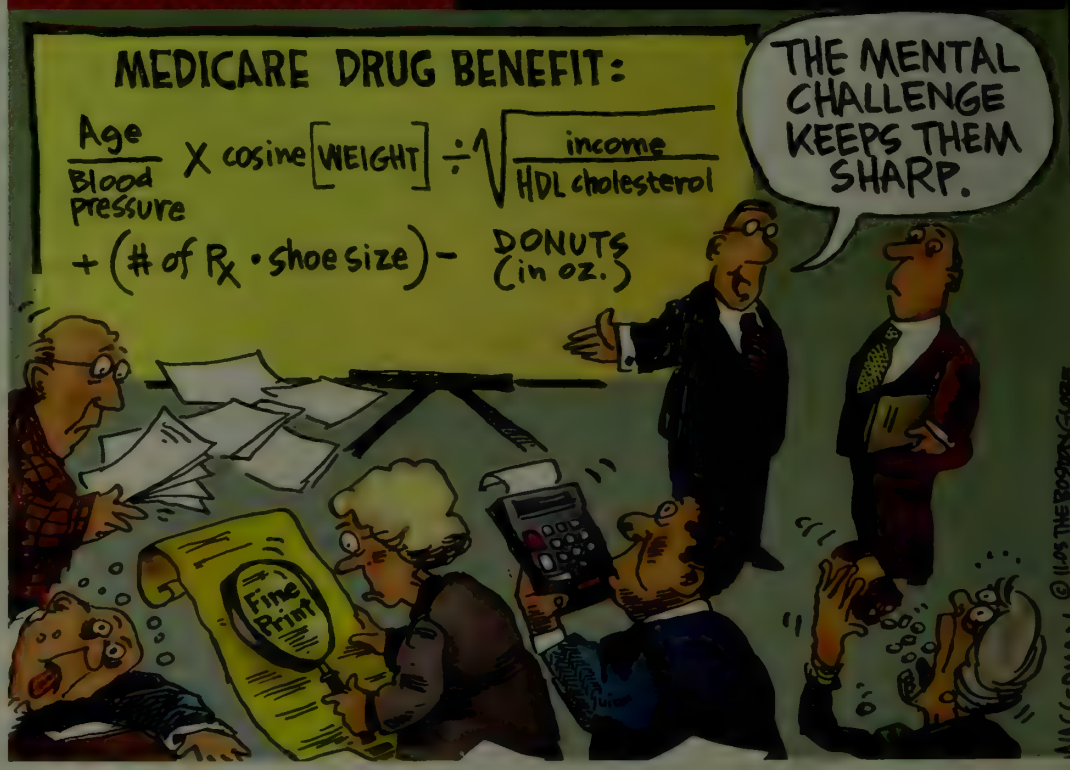

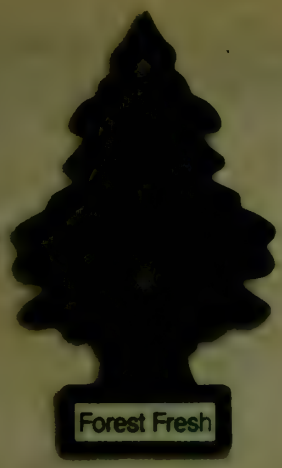

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HEADLINER

BARRY MEYER

BEGONE, YOU ICAHN OF DARKNESS

Warner Bros. Entertainment has just the answer to corporate raider Carl Icahn's attack on parent Time Warner: unleash the full power of Harry Potter. Warner's top execs, CEO Barry Meyer and President Alan Horn, worried that the boy wizard's franchise was a bit tame for fast-maturing kids. So they ramped up the special effects and the scares and turned *Harry Potter and the Goblet of Fire* into a PG-13 flick. It opened on Nov. 18 with a $102.3 million weekend gross.

Pottermania returns at a good time for Meyer and Horn, who took over the studio in 1999. To boost profits and stave off Icahn, they laid off 6% of the staff this fall and offered stars such as Brad Pitt profit slices in place of some up-front payments. Still, the new Potter cost $155 million to make, compared with $120 million for 2004's *Harry Potter and the Prisoner of Azkaban*. If Meyer, Horn, and Time Warner continue to conjure box-office magic, it may help to keep Lord Icahn at bay. *–Ronald Grover*

RETAIL FOLLIES

TO SCAMMERS, THEY'RE GRIFT CARDS

LAST HOLIDAY SEASON, harried shoppers fell in love with gift cards. This season, scammers are warming up to them, too. With sales of gift cards expected to approach $19 billion, up 7% from 2004, according to the **National Retail Federation** (NRF), they make a tempting target. The latest tricks take advantage of the casual way stores openly display cards at checkout counters—and that the value is stored on a central database, not in the cards themselves. "Cloners" swipe, then replace, the cards after making exact replicas. That fools the store's computer into thinking they're the real thing. "Swappers" make copies of a card's bar code and leave the copycats in stores. Each time a copycat card gets activated (and the scammers call in to check), only the bogus card is credited by the database.

Retailers love cards, which allow them to collect money now and hand over goods later. So far, only a few stores report being stung, says Joe LaRocca, NRF's vice-president for loss prevention. But as more cases pop up, NRF has created a gift card working group. A number of retailers, including **Macy's**, **Gap**, and **Best Buy**, let consumers check their card balances online. Now stores also are taking defensive measures, such as limiting inquiries about a card, particularly if it's not activated. *–Elizabeth W*

THE BIG PICTURE

McBUCKS? STARNALD'S? McDonald's and Starbucks come from vastly different worlds—cheap, fast hamburgers, vs. $4 coffee. But as they tweak their formulas so-far limited experiments, the chains begin to look oddly similar:

	McDONALD'S	STARBUCKS
FOOD	Replacing house java with an upscale organic blend by Green Mountain Coffee Roasters at 600 New England stores.	Selling premium hot breakfast sandwiches in Washington, D.C., and Seattle, expanding to 600 stores next year.
FACILITIES	Remodeled thousands of stores, some in earth tones, with leather sofas and soft lighting.	Plans to open more than 300 drive-through stores by next fall, an increase of approximately 30%.
MUSIC	Paired free digital music downloads with Extra Value Meals in 2004; dabbled this year with digital media kiosks.	Co-produced albums, including Ray Charles's *Genius Loves Company*. Has 41 music media bars.
WI-FI	Has offered wireless Internet access for a fee; expanding with free Nintendo Wi-Fi network in 6,000 stores.	The name is practically synonymous with Wi-Fi; has hotspots in more than 4,300 coffee houses in the U.S.

Data: *BusinessWeek*

(CLOCKWISE FROM TOP LEFT) PHOTOGRAPH BY ERIC CHARBONNEAU/WIREIMAGE.COM; PAUL TAYLOR/GETTY IMAGES; ILLUSTRATION BY CHRISTOPH HITZ

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"It seems the only thing everyone cares about nowadays is where to buy the most 'cheap stuff' at the lowest prices."

–Steven Happel
Dallas

PERCEPTION, REALITY, AND IKEA

IT COMES AS NO SURPRISE to read "Ikea" (Cover Story, Nov. 14), on the ascent of Ikea as one of the premier retailers in the world. Through shrewd design, sourcing, merchandising, and marketing, it has found itself a large niche that appeals to the masses worldwide.

However, it is a sad commentary on the state of retailing to read in various articles in your publication that the most successful retailers are ones such as Wal-Mart, Target, and Ikea. Gone are the days of giving your patronage to the store that can provide the best shopping environment, customer service, and quality, well-made products. It seems the only thing everyone cares about nowadays is where to buy the most "cheap stuff" for the lowest prices. This is happening to every service industry.

–Steven Happel
Dallas

YOUR ARTICLE NEVER mentioned the quality of Ikea products—or lack thereof. I bought three rooms of their catalog products several years ago. First they were missing parts, now they're falling apart. If my children still lived with me, the pr ucts wouldn't have lasted even this lon

–Ray Bran
Clevel

THE COST OF COLLEGE —AND THE PAYOFF

MY HEART GOES OUT to those rec college grads strapped with six figure debt incurred by college tuition and ing expenses while acquiring their c lege education ("Thirty & broke," S cial Report, Nov. 14). In the '70s, I able to put myself through college working in the summers and part-ti during the school year. With the price tuition now, that is impossible. Inste of investigating alleged price-gouging oil companies, we should investig price-gouging by colleges and univer ties. Students should not have to w 30 years to pay off their tuition.

–Gregg McConn
Newbury Park, Ca

AS ANOTHER BROKE 30-year-old, thought this week's article hit home. Wi the assumption that paying off $20,000 in undergrad loans would easier with boosted earning power, I d

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cided to go back for an MBA. I refused to assume the debt required to enter the best local program. I chose instead a more affordable program administered by a small school in a sleepy East Texas town.

Still, I find myself wondering, will my choice of a less prestigious program hurt my career, even as my bank account (sometimes) stays in the black? Will I ever own a house? How will I move to another city when my degree is done? Will this degree pay off? When?

–Courtney Benjamin
Dallas

MY WIFE AND I expect to finish our graduate degrees (JD/MBA and PhD, respectively) with about $180,000 in student loan debt. If we stick to the prescribed repayment plan we will finish paying off our loans when we are 63, just two years before we're eligible for Social Security. As daunting as that is personally, I fear for our public colleges. They increasingly rely on alumni giving to make their budgets work. If alumni are strapped paying off loans, how will schools make ends meet?

–Greg Sower
Salem, Ore.

YOUR ARTICLE both shocked and appalled me, not because it has echoes of my own story, but because of the level of indulgence and lack of financial self-discipline I saw in the young adults this article profiled. I, too, am 27 and $74,000 in debt from my graduate school education. Because of my debt, I have learned to put my credit cards on a "time out"—and not purchase big-ticket items like computers, electronics, cars, or houses. And yes, I am putting off marriage and children. However, I do not feel entitled to a job, so I work very hard, and any extra money goes toward paying off those loans. A little self-discipline would go a long way for our generation.

–Julia Rymer
Lakewood, Colo.

BEING A SENIOR only one month from graduation, just reading your headline, I began to imagine myself 30 and broke. After reading your story, I realize that there are people out there just like me, some even worse, who are getting through repayment just fine. My attitude about "life during repayment" has changed considerably.

–Ben Cooley
Elk River, Minn.

THE EDUCATION I RECEIVED at my local community college, St. Petersburg College, was just as good as I got at Mount Holyoke College—and for a fraction of the cost! My advice to young people is to avoid college debt as much as possible: Attend your local community college, live at home with your parents, get rid of unnecessary expenses, and try to have an employer pay your tuition. IBM paid for my entire MBA degree, including the cost of books.

–Karen M. Linz
Dunedin, Fla.

DEAR MOM AND DAD: I will never be able to convey how appreciative I am for the huge sacrifices you made in paying for the majority of the cost of my college education. The only way I can truly thank you is by returning this favor some day to my children.

–Neal W. Bonner
Ellicott City, Md.

CORRECTIONS & CLARIFICATIONS

In "Digital is our destiny" (Media, Nov. 28), Random House was incorrectly identified as one of five plaintiffs suing Google, alleging copyright violations. The publisher says, however, that it supports the lawsuit.

"Wireless heads for the hills" (Up Front, Nov. 28) incorrectly states when On.Net was started. The correct date was 2000.

In "Get set for wider exposure" (Up Front, Nov. 28), iN DEMAND's chief executive was misidentified. He is Rob Jacobson.

"Where Ridder went wrong" (Media Centric, Nov. 21) incorrectly stated that San Jose is a smaller city than San Francisco.

COMPUTER ASSOCIATES: THE BOARD IS SOUND

ALTHOUGH WE FOUND "Computer Associates: Clearing a cloud" (Management, Nov. 21) a thoughtful and accurate portrayal of the company's progress and challenges, we disagree with the assertion of some management experts that board members who were in place during the troubled years should be automatically removed.

The actions of Lewis Ranieri, who joined the board in 2001, and former Senator Alphonse D'Amato (R-N.Y.), who joined in 1999, have been essential to CA's turnaround. As the lead independent director and later as chairman, Mr. Ranieri played a critical role in launching the independent Audit Committee investigation into the company's accounting, which led to the removal of many of company's top managers. And as a me ber of the Audit Committee, Sena D'Amato was instrumental to the succ of that investigation.

Mr. Ranieri also led the negotiati with the government that resulted in deferred prosecution agreement. guidance and active involvement in business helped ensure stability dur the period when the company was wi out a permanent CEO. Furtherm Mr. Ranieri and Senator D'Amato w key participants in the company's effo to attract outstanding new leaders, cluding CEO John Swainson. CA's sha holders will be well served by their c tinued contributions.

–Dan Kaf
Senior Vice-President
Corporate Communicati
Computer Associa
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BY STEPHEN H. WILDSTROM

I Hear a Symphony

Lovers of classical music, though relatively few in number, are deep of pocket. Yet the digital music revolution has all but ignored them. The classical selections available online are limited, and the quality of downloaded music is inadequate for serious listening on good audio systems. The lack of sensitivity to this genre, in all its forms, is clear when the classical section of Apple's iTunes Music Store lists a recording of Yo-Yo Ma playing J.S. Bach's *Suites for Unaccompanied Cello* as one of its "Top Songs."

OLIVE SYMPHONY DIGITAL MUSIC PLAYER

Even when you rip your own CDs to hard drives, things are still unhappy in classical music land. Most computers' sound quality is poor, and networked players that connect to your audio system, such as the Roku SoundBridge, have no concept of a symphony as a single work divided into movements, or that it's annoying to have a pause inserted between tracks in an opera.

The $899 Symphony from startup Olive Media Products is the first digital player I have seen outside of the world of five-figure custom-installed systems that really handles classical music properly. The Symphony copies your CDs to a hard drive as a PC or an iPod does, but in the way classical music should be done: at top quality and with respect for the integrity of the works. You immediately notice two things when you turn it on: a liquid-crystal display readable from across a room and the almost total lack of noise, the result of using a super-quiet hard drive and no cooling fan.

YOU LOAD MUSIC ON TO THE SYMPHONY simply by inserting a CD into a slot and pressing the "Import" button. While it can save the files as MP3s, it makes more sense to use FLAC lossless compression, which cuts the storage requirement of a CD about in half. The 60-gigabyte drive—the largest currently available in the ultra-quiet design used—will hold about 200 CDs worth of music. Importing your CDs one at a time gets tedious, so Olive offers a deal. You send the company your CDs when you order a Symphony, and it will ship the player with your music loaded; you pay just for the round-trip shipment of the disks. The Symphony can also play CDs directly, and I could not tell the difference between the original and the ripped version on Symphony, not only in sound quality but the spacing of tracks. If the CD has no gap between, say, the third and fourth movements of Beethoven's *Fifth Symphony*, neither will the Symphony version.

The controls of the Symphony are modeled on the iPod's. Turning a wheel on Symphony's front panel lets you scroll up and down through a list, while turning an outer ring left or right moves you up or down through menu levels. The player comes with data on about 2 million CDs—most anything commercially available—and this can be updated if your Symphony has a wired or wireless connection to the Internet.

The Internet connection can also be used to play music stored on a Mac or Windows PC or to play the Symphony's music on a computer. But I found that a standard wireless network has trouble with the lossless compression; the music was plagued by brief but very jarring interruptions when handled this way.

Finally, a system that respects classical music

My biggest disappointment with the Symphony was the Mac-only Playlist software, which allows you to create play lists and to edit music descriptions using a greater variety of data than that allowed by iTunes and other player software. But the program is seriously buggy, and Olive is in the process of rewriting it. A version for Mac, Windows, and Linux should be out early next year. In the meantime, you can edit on the Symphony itself, but the process is painful.

The lack of good PC editing software makes it hard to clean up the numerous errors and omissions in the CD database, but this is mostly just a nuisance. The Symphony stands on its own as the first affordable player that really treats classical music with the respect it deserves. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

An Adman's Guide to Survival

Bob Greenberg is made for the part. The fringe of untamable hair, the hip-professor specs, the all-black wardrobe, the geek-chic demeanor underscored by the gnomic utterances he serves up with Yoda-esque calm. ¶ Greenberg is the sort of media futurist who has stopped talking about the "third screen" (on your cell phone) because he's onto the fourth (massive outdoor digital signage—think Times Square or Tokyo). The 57-year-old CEO and chief creative director of Interpublic Group's New York-based interactive ad agency R/GA has made much noise of late outlining what ad agencies must do to survive this media moment. As he sees it, as bad as the current great unraveling is for TV and newspapers, it's worse for ad agencies. "They aren't in the business of ads anymore," he says.

Their new business of selling is a far cry from the days of mass media models. Ad agencies now have to be conversant with information architecture, he says. They also have to be able to design e-commerce, play in the world of personalized media, and create retail environments.

The jargon boils down to an agency that creates marketing—or a marketing experience—that blends the strictly functional with gamelike gewgaws to draw consumers on entertainment value alone. R/GA itself is behind both the Nike iD Web site—on which sneaker freaks can endlessly design their own kicks—and Circuit City's unflashy but smartly efficient e-commerce site.

Greenberg's vision of the agency of the future, coincidentally, describes with some accuracy R/GA, in which information technologists, data analysts, and so-called experience designers work closely with more traditional ad types. Any seer's spiel can get tired quickly, all the more so should said seer promote his own company as an exemplar of the new world. But judging by the swelling ranks of clients and admirers, Greenberg is worth listening to. His agency has won numerous prizes for work found at all points along the hipness spectrum, from Purina to Subaru to Nike iD. In the past year its staff size has shot up from around 315 to more than 400.

R/GA once produced first-generation digital movie effects (including *Zelig* and *Altered States*), then morphed into an interactive agency—a good perch from which someone like Greenberg can rethink these strange days. How strange? Executives from five TV networks jointly held a Nov. 16 press conference to insist that wider adoption of digital video recorders does not equal more ad skipping. They had better talk fast. Top marketers such as Samsung and Verizon (an R/GA client) have said they have at least tripled Internet ad spending. This presents problems for agencies, since TV ads are, historically, their most profitable business. "Agencies have to push the 30-second spot. Their whole financial model depends on it," says Greenberg.

Enter R/GA and its post-mass media approach. "Bob and his folks are obviously very smart and cutting-edge," says Verizon Senior Vice-President Jerri DeVard. "It's not just about putting something cool out there but looking at all the metrics first." For Verizon, R/GA designed richerdeeperbroader.com, where users can submit videos that sing the praises of a broadband world.

To Bob Greenberg, agencies must reinvent themselves top to bottom

Greenberg gets just as enthused about all the technical underpinnings as he does about big-brand stories. One pet project: a computer program that lets multiple agencies track complex collaborative ad projects. He hasn't decided whether to sell it or just make it available, open-source-style.

Sometimes you can glimpse the future in a bit of code and some sharp information design. Advertising was once the domain of decades-old icons ho-ho-ho-ing on TVs everywhere and bigger-than-life executives wielding lavish entertainment and dining budgets. That hasn't all gone away—far from it. But if Greenberg is right, the future of a business built on surface and bluster may yet be distilled into a sharply designed spreadsheet. You needed more proof that the geeks are taking over? ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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The Barker Portfolio

BY ROBERT BARKER

Hotter Than It Looks

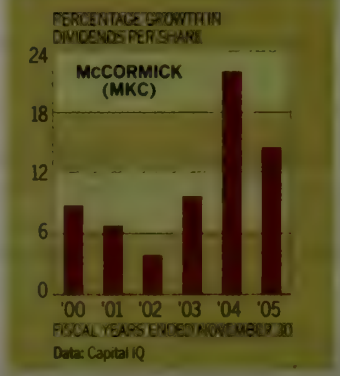
Many people don't care for eggnog. But just try getting through the holidays without being offered a cup. Chances are, the spice in it will be McCormick's, and if that leaves a bad taste in your mouth, you're probably a stock analyst: Of the 13 who track McCormick, Standard & Poor's lists just one who rates it a buy.

Ubiquitous as its nutmeg, cinnamon, pepper, herbs, sauces, and marinades may be, the world's No. 1 seller of flavorings comes into the holiday season this year unwelcome on Wall Street. From over 39 in January, the stock recently traded under 29. The reason is a pair of revisions last summer in the company's earnings expectations for fiscal 2005, which ends on Nov. 30. From its initial forecast of $1.72 or so in earnings per share, McCormick now expects $1.58 to $1.62. Chief Executive Robert Lawless remains undaunted. "We'll get back on track in 2006," he told me. "No one should hold the view of us that we have a damaged business strategy."

CHIEF EXECUTIVES, ESPECIALLY those scrambling to find their way back into investors' good graces, rarely say anything very different. Just the same, the steadiness of McCormick's 116-year-old business along with its sturdy financial position—debt is 45% of capital, down from 59% in 2001—lead me to think that the shares represent a buying opportunity. For one thing, the way the Street is treating the stock, you would think McCormick is suddenly losing money on its $2.6 billion in revenues. Instead, growth in earnings per share has slowed abruptly, to 5% or so this year from an annual average of 11% in the five years ended Aug. 31, according to S&P's Capital IQ data-services unit.

McCormick had been able to outpace the food industry by diverting its steady excess cash flow—$290 million after capital spending over the past four quarters—in a variety of salutary directions. These include higher dividends (chart); share repurchases, currently through a $400 million program that began in June right after a $300 million buyback budget was exhausted; selected acquisitions, such as 2003's $180 million deal for the Zatarain's brand of New Orleans-style foods; and development of higher-margin products, including a group of barbecue sauces, marinades, rubs, and seasonings called Grill Mates. Another new line is Grinders, which are a variety of ungrou peppers, salts, and herbs that come in bottles with an integrated grinding tool.

PORTFOLIO SPICE



So, what went awry this year? For starters, t company saw its gross margin squeezed by holding a big inventory of high-cost vanilla beans even as competition cut the prices fetche by its vanilla products. Lawless told me the vanilla market is now stable. Then came Hurricane Katrina, which Lawless blames for 2 a share or so of the decline in this year's estimated earnings. The Zatarain's unit has bee able to maintain production, but regaining orders from the many retailers and restaurants still reeling from Katrina will suppress demand for an unknown period of time.

A bigger problem is in McCormick's industrial-products segment, which caters to other food processors and restaurateurs (think spicy tortilla chips and hot buffalo wings). It makes up less than half of sales an about a third of operating income. Through this year's first nine months, the segment's operating income sank more tha 12% on a slight rise in sales. One reason was delays in its customers' new-product introductions, which figure to push sales that McCormick had anticipated for 2005 into next year Another was price-cutting, as competitors angled to take market share. In any case, in September Lawless outlined a plan to take $30 million to $45 million out of its annual costs over the next three years via supply-chain efficiencies and also to trim less profitable items. He figures that as McCormick consolidates its global manufacturing and distribution assets, pretax charges of up to $130 million will result.

When McCormick reports its fiscal 2005 results in late January, investors can expect Lawless to offer fresh guidance on future sales and profit growth. Will the company continue to promise the 10% to 12% in average annual earnings per share gains that the Street had come to take for granted? There's no guarantee naturally. Yet with the stock now trading down at multiples of enterprise value (1.8 times revenue, 13 times operating income) not seen in more than two years, it's priced to benefit from any nice surprises. ■

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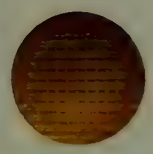

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BY JAMES C. COOPER & KATHLEEN MADIGAN

Tech Is Pumping Life Into Manufacturing

Factory activity will support growth in 2006 as consumers scale back

U.S. ECONOMY In an economy growing at a pace close to 4%, perhaps it's not surprising that manufacturing is in a rebound. What may turn heads, though, are the sources of the revival. Makers of advanced technology equipment, almost given up for dead after the bursting of the tech bubble, have been on a tear recently, boosting output, thanks to the gains in capital spending. And exports are stirring to life, animated by better growth prospects around the world, especially since Europe and Japan are finding firmer footing.

Meanwhile, post-hurricane rebuilding, fueled partly by federal money, and still-strong demand overall will boost goods production. Plus, businesses may have been too cautious about managing their inventories this summer. Now stockpiles are skimpy, and the backlog of factory orders has grown rapidly over the past six months.

Given the brighter picture for output, it's no wonder manufacturing executives are growing more upbeat. A survey of chief financial officers in the factory sector done by Bank of America Business Capital showed that 73% of CFOs expect their company's revenues to increase in 2006, with 68% expecting increased export sales and 61% planning to lift prices.

Of course, the factory sector still faces long-run challenges. The recent news from General Motors Corp. illustrates that U.S. manufacturers must adapt to the new global economy or risk failure. But in the short run, the strong gains in demand greatly improve the 2006 outlook for manufacturing. That means overall economic growth will remain sturdy next year even if consumers begin to scale back their spending in response to higher heating bills and a cooling off in home prices.

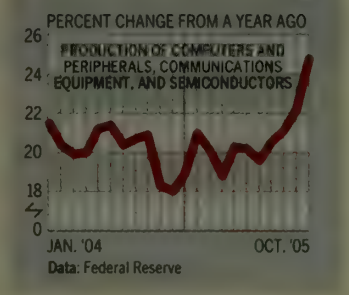
Given that the growth in industrial output is being led by advanced technology, companies still appear to be heeding the productivity imperative. Productivity growth, which is expected to slow next year, is unlikely to collapse as it has in past business upturns. That will limit inflation pressures in 2006 as well as curb the rise in interest rates.

FACTORY OUTPUT is on track to expand by close to 3½% this year, but the pace in recent months has been even faster. Factory production jumped 1.4% in October, lifted partly by a return to operation after the strike at Boeing Co. and a rebound from September's post-hurricane depressed levels. But even after adjusting for those events, the strength was broadbased.

The gain was consistent with the generally robust results from the October surveys of industrial activity. And based on regional surveys so far in November, including those from the New York and Philadelphia Federal Reserve districts, November output is also set to score a strong advance.

The steady rise in output has caused companies to start using more of their facilities. In October manufacturers used 79% of their production capacity, close to the long-term average of 79.8%. Excluding the industries where production was still down after the hurricanes, the operating rate exceeded 80%.

OUTPUT OF HIGH-TECH HARDWARE TAKES OFF



Data: Federal Reserve

But the real force behind manufacturing production this year is tech equipment. Output of semiconductors, computers, peripherals, and communications equipment has shot up 25% during the past year, the fastest annual clip in nearly five years (chart). So far in 2005, business outlays for information-processing gear have accounted for two-thirds of all equipment spending, up from only one-third in 2004.

Business equipment will continue to lead industrial growth in 2006, according to the latest quarterly forecast from the Manufacturers Alliance/MAPI. The research group expects overall real investment in equipment and software to grow 9.3% in 2006, with outlays for info-processing hardware up 13%, close to the current pace. One possible downside to tech-led growth: It may be contributing to a growing shortage in skilled workers. A study by the National Association of Manufacturers and Deloitte Consulting LLP showed that 81% of the more than 800 U.S. manufacturers surveyed reported moderate to severe skilled worker shortages.

BESIDES THE GREATER DEMAND for tech equipment, manufacturers are also seeing a pickup in orders from foreigners. And that increase should continue into 2006.

Price-adjusted exports increased a solid 7.5% in the year ended in the third quarter. The gain probably

would have been larger, but the Boeing strike held down overseas shipments of aircraft (chart). Now that it's over, look for aircraft exports to bounce back in the fourth quarter. Real merchandise exports for the full year should increase close to the 9.1% advance seen in 2004. Demand has picked up for a wide swath of goods, including pharmaceuticals, plastics, specialized industrial machinery, and steel products.

The outlook for exports is improving because global growth is more promising too. The euro zone expanded at an annual rate of 2.4% in the third quarter, its best showing in 1½ years. Third-quarter growth in Japan's real gross domestic product slowed a bit, but domestic spending picked up, boosting the nation's demand for U.S. exports. And Southeast Asia continues to grow like gangbusters.

It's not just the data that signal better prospects. The attitude of central bankers around the world also suggests that economic growth in their regions is picking up—and that is paving the way for higher interest rates. Policymakers at the European Central Bank already have implied strongly that they are set to begin hiking rates in December. Meanwhile, Bank of Japan officials have ruffled some political feathers by indicating that the BOJ will start moving monetary policy away from its accommodative stance to a more neutral one.

THE RISE IN FOREIGN RATES may reverse some of the recent strengthening in the greenback, making American products cheaper overseas. That's because a narrowing of the spread between U.S. and foreign interest rates will make dollar-denominated assets relatively less attractive.

Still, the pickup in exports won't do much to narrow the huge U.S. trade deficit. Higher oil prices alone will push up the import total. Plus, U.S. demand is solid enough to keep other imports flowing in. That means the foreign trade sector will still be a drag on economic growth.

But the latest news on foreign purchases of U.S. securities suggests that foreigners are still more than willing to finance America's trade gap. Net foreign purchases of U.S. securities hit a record $101.9 billion in September, including especially strong demand for U.S. equities and corporate bonds. The capital inflows suggest that any weakening in the dollar will not happen quickly even with the increase in foreign interest rates.

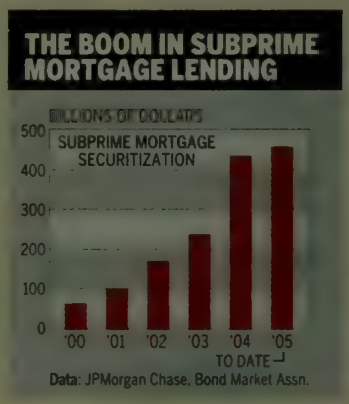
Regardless of the dollar's value, U.S. manufacturers will continue to face unprecedented global competition. That, plus the need to enhance productivity, will keep the pressure on factory revenues and payrolls. But in the short run, at least, recent improvement in the manufacturing sector is one of the best signs that the U.S. economy will maintain its momentum into 2006. ■

HOUSING

Where the Market is Most Vulnerable

HARDLY A WEEK goes by without some new sign that the housing boom is finally over. Most recently, October housing starts dropped, and permits to begin new construction posted the largest monthly decline in six years. And in November, builders' assessment of market conditions sank to a two-year low, says the National Association of Home Builders.

The size of the drop-off in activity and the broader impact on the economy are still anybody's guess. But one area—the subprime mortgage market—is causing some nail-biting among economists. The explosion in subprime lending, aimed at borrowers who do not have the income and credit standing to qualify for a conventional loan, accounted for an unusually large chunk of housing demand over the past five years. Now, with interest rates rising and home prices cooling, that boom is about to become a bust.



Exact data on subprime lending is hard to come by, but according to Bond Market Assn. figures on mortgage securitizations pulled together by analysts at JPMorgan Chase, subprime mortgage originations grew sevenfold from 2000 to 2005. Subprime loans now account for nearly 9% of all securitized mortgage debt, and the average loan is now nearly $200,000.

What's more, some 82% of that debt is in adjustable-rate loans, where rates can rise more rapidly than long-term fixed rates. Morgan estimates that if the Federal Reserve lifts its target rate to 5%, then fixed mortgages will rise about a percentage point by the middle of 2006, to about 6¾%, but the initial rate on subprime loans would jump by three points, into the 9.5%-10% range. The adjustment for existing subprime borrowers would push up monthly payments by some $250 dollars, on average.

How much added pressure will the end of the subprime lending boom exert on the housing slowdown? "It is clear that this part of the market would be especially hard hit and would amplify the expected slump in home sales in the part of the market financed by conventional mortgages," says Morgan economist Robert E. Mellman. Where will the blow be the hardest? California. The state accounts for nearly 30% of U.S. subprime lending. ■

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Downsizing in Detroit **General Motors'** revival plan shifted into second gear. In early November it chopped health benefits for retirees by $1 billion. Then, on Nov. 21, CEO Rick Wagoner (photo) said he will jettison 30,000 jobs, shutter 10 U.S. plants, and shrink output at others. But will that stop the carmaker from rolling downhill? Investors don't think so: The stock slid 3.2% by Nov. 22. Some GM insiders say the auto maker may eventually need to cut more. **Ford**, meanwhile, is headed down the same road. It's trimming 4,000 white-collar positions, and executives say it, too, will announce big restructuring steps soon.

As if that weren't enough of a flat tire, consider this: **Toyota** may end GM's 73-year reign as the world's No. 1 carmaker next year or in 2007. While GM is shedding capacity, its Japanese rival is opening a pickup truck plant in San Antonio and scouting locales for another factory in North America. GM made 9 million cars and trucks last year and Toyota 7.4 million. But in 2005, GM expects to turn out 9.1 million and Toyota 8.2 million. You get the idea.

See "GM's slimmed-down economy model," www.businessweek.com/go/tbw

Cisco Dials Scientific-Atlanta **Cisco Systems** is famous for its formulaic approach to the art of the high-tech acquisition. It almost always sticks to buying tiny outfits located near its Silicon Valley headquarters that boast promising Net-based technologies. So why does the network-gear giant want 50-year-old Scientific-Atlanta, which makes cable set-top boxes—a product that many think is headed for commodity hell or total disappearance in a few years? The $6.9 billion deal, announced on Nov. 18, may help Cis land huge contracts with cable and phone compani Most of them want to offer customers "quadruple pla bundles: broadband access, Net phoning, wireless, a video on demand. While Cisco already excelled at the fi three, the purchase will make it a master in the video real as well. For good measure, Cisco on Nov. 22 inked a maj deal with Chinese telecom gear maker **ZTE.**

See "Cisco's bold new TV be www.businessweek.com/go/tl

Bush Hits the Great Wall Christmas gift suggestion T-shirt for **President George W. Bush** that says, "I went China, and all I got was this lousy **Boeing** deal." Actually wasn't so lousy (see following item), but it also was no su prise, since Beijing's leaders like to reward their U.S. cou terparts with buy orders to help smooth ties. During h Nov. 19-21 visit, Bush called on Beijing to end piracy U.S. software and entertainment, pay more heed to huma rights, and ease currency controls on the yuan. As in t past, Beijing politely promised to think about it. Bush sa the two sides made progress on North Korea and avian fl

Boeing's Fat Order Book And as for Boeing, its rece scores aren't even the big ones it's dreaming of. But he who's complaining? At the **Dubai Air Show** on Nov. 20-2 the Chicago planemaker booked orders for 42 of its 7 models, worth about $9.7 billion at list prices—though t buyer likely got a discount up to 30%—and 26 of its 7 Dreamliners, valued at nearly $3.5 billion. In Beijing Nov. 19, Chinese officials said they will buy 70 of the 7 narrowbodies, list price $4 billion, and may take 80 mo in the near future. Next, the trifecta: **Singapore Airlines, Qa tas,** and **Cathay Pacific** are likely to spring for monster orde in December, and analysts pick Boeing to win the bulk them. The sales cap a year when Boeing took wing agai It may outfly **Airbus** in orders for the first time since 1999

See "Boeing roars ahead," BW–Nov.

TiVo Declares War Hollywood's drive to make a litt extra dough off video junkies has run into a pesky rebe TiVo announced on Nov. 21 that its customers soon will b able to grab just about anything on TV without having pay the folks who created it. Instead, TiVo would get t proceeds from a subscription plan that allows users download programs to **iPods** and **Sony's PlayStation Portabl** That means war, since TV and movie execs are bent on co trolling who can view their shows—and on bagging the fair share. The struggling digital video recording pione may face the fight of its life.

GE Exits Reinsurance Remember the halcyon days GE Capital? That was the mysterious finance side of **Gene al Electric's** operations—a black box of businesses rangin from insurance to credit cards that accounted for almo half of earnings during the last days of **Jack Welch.** The **Jeff Immelt** took over, lifted the veil, and revealed insuranc to be, relatively speaking, a dog. It ate up too much capita

didn't grow fast enough, and produced choppy returns. Last year, GE spun off a chunk of its life- and mortgage-insurance business, now called Genworth. On Nov. 18 it sold the reinsurance business for $6.8 billion in cash and stock to Swiss Re. Sure, 2006 may prove a topping year for reinsurers as they spike rates in reaction to natural disasters, and Swiss Re, now the world's largest reinsurer, thinks it can make money where GE can't. But that won't shake Immelt. In any weather, this is one business he's glad to lose.

Tighter Money in Europe Politicians gave **European Central Bank President Jean-Claude Trichet** a drubbing when he appeared before a European Parliament committee on Nov. 21. They were outraged that he had suggested the bank would raise rates on Dec. 1, just when the EU economy was showing signs of life, growing at a 2.4% annual rate in the third quarter. But the expected 0.25% increase, bringing the benchmark rate to 2.25%, probably won't throttle growth. And it's needed to preserve the ECB's credibility as oil prices heat inflation above the bank's 2% comfort zone, Trichet argued. He reminded the legislators that the euro zone would be better off if certain states could tame their budget deficits. He didn't name names, but France, Germany, and Italy spring to mind.

An Xbox Xmas Hard-core gamers braved the chill to lay their hands on the first **Xbox 360s** at the stroke of midnight on Nov. 22. The **Microsoft** machine leads the next generation of video-game consoles, featuring high-definition video and hot networking technology. Microsoft figures to sell up to 3 million in three months, well before rivals **Sony** and **Nintendo** get their new devices to market. Those numbers sing sweetly to retailers, who may be in for happy holidays. What with strong Xbox sales and gentler gas prices, they're likely to take in $439.5 billion in November and December, up 6% from the year before, says the National Retail Federation. Only two months ago the group was projecting a 5% gain.

See "Microsoft's red-ink game" and "A bit of cheer for holiday sales," www.businessweek.com/go/tbw

Street Strength After doing the dead man's float for most of the year, the stock market hopped on a speedboat. In the strongest four-week stint of 2005, the Dow jumped 6% from Oct. 21 through Nov. 22. Can the ballyhooed end-of-year rally continue? Certainly. Many investors are gaining confidence that the Fed will quit hiking short-term rates next year without having torpedoed the economy and corporate earnings. That's why economically sensitive stocks, such as **Caterpillar** (page 56) and **Alcoa,** are leading the move. Buyers also feel better because energy prices are sliding instead of climbing toward doomsday peaks. Despite the run, stocks aren't yet expensive. The Dow is barely higher than on Dec. 31. The odds favor this rally.

The Cosmetic Medicine Catfight Count on one thing as boomers age: Treatments that hide the evidence will ring up beauteous sales. That's why four major players seem so sexy to one another. **Medicis** (anti-wrinkle drugs) wants **Inamed** (breast implants) and was close to completing a deal for $2.8 billion. Along came **Allergan** (Botox) on Nov. 15 with a $3.2 billion proposal for Inamed. Not to be left out, **Mentor** (liposuction) offered $2.2 billion for Medicis a few days later. Medicis snubbed Mentor and on Nov. 22 asked Inamed's board to rally shareholders to reject Allergan. Mentor refuses to go away, saying its Medicis offer stands. A date to watch in this bedroom farce is Dec. 6: If Inamed's board doesn't recommend by then that shareholders spurn Allergan, Medicis can terminate its own offer and console itself with a $90 million broken-engagement fee. It's enough to give anyone blotchy skin.

Chávez' Propaganda Coup So you live in the Bronx, and you're worried about your heating bills. Who ya gonna call? Hugo Chávez, that's who. The Venezuelan President has discovered an ingenious new use for **Citgo**, which is owned by state oil company **PDVSA:** shaming his archenemy, **President Bush.** Citgo will supply 12 million gallons of heating oil at a 40% discount to 40,000 low-income households in Boston and New York. The $10 million gesture is a drop in the bucket for PDVSA, which expects $6 billion in 2005 profits. Chávez, a close ally of Fidel Castro, has infuriated Washington since becoming president in 1999. But he has earned a friend in Representative Bill Delahunt (D-Mass). "It is gratifying that at least one major oil company is willing to step up to help," he says.

Loser of the Week

Can't a guy hold an intimate $62,000 birthday party for his wife in peace? Not if much of the cash may have come from company coffers. Former **Hollinger International CEO Conrad Black** is due in Chicago on Nov. 30 to face eight counts of fraud stemming from his alleged abuse of perks and charges that he "fraudulently diverted" almost $84 million. Although he faces up to 40 years in jail, the fallen media baron continues to rage against anyone who suggests he did wrong. Black, 61, faces heat from regulators on both sides of the border and has been playing jurisdictions against each another. He wants the Supreme Court of Canada to rule that U.S. prosecutors have no power over his Toronto holding company, **Ravelston.** And he has essentially tried to take the Fifth—despite there being no Fifth Amendment in Canada—arguing that what he says there could be used in the U.S. case. Black's lawyer, Edward Greenspan, says his client has always acted within the law.

CONRAD BLACK

See "Black Thursday for Conrad," www.businessweek.com/go/tbw

MARKETING

THE GREAT REBATE RUNAROUND

Consumers hate the hassles and hoops. Companies love them unredeemed. Now regulators are wading in

BY BRIAN GROW

AH, THE HOLIDAY SHOPping season: Santa Claus, reindeer—and rebate hell. Those annoying mail-in offers are everywhere these days. Shoppers hate collecting all the paperwork, filling out the forms, and mailing it all in to claim their $10 or $100. But no matter how annoying rebates are for consumers, the country's retailers and manufacturers love them.

From PC powerhouse Dell to national chains Circuit City and OfficeMax to the Listerine mouthwash sold at Rite-Aid drugstores, rebates are proliferating. Nearly one-third of all computer gear is now sold with some form of rebate, along with more than 20% of digital cameras, camcorders, and LCD TVs, says market researcher NPD Group Inc. Hal Stinchfield, a 30-year veteran of the rebate business, calculates that some 400 million rebates are offered each year. Their total face value: $6 billion, he estimates. Office-products retailer Staples Inc. says it and its vendors alone pay $3.5 million in rebates each week.

Why the rage for rebates? The industry's open secret is that fully 40% of all rebates never get redeemed because consumers fail to apply for them or their applications are rejected, estimates Peter S. Kastner, a director of consulting firm Vericours Inc. That translates into more than $2 billion of extra revenue for retailers and their suppliers each year. What rebates do is get consumers to focus on the discounted price of a product, then buy it at full price. "The game is obviously that anything less than 100% redemption is free money," says Paula Rosenblum, director of retail research at consulting firm Aberdeen Group Inc.

THE STAT

40%

Share of rebates that never get redeemed

Data: Vericours Inc.

The impact on a company's bottom line can be startling. Consider TiVo Inc. The company caught Wall Street off guard by sharply reducing its first-quarter loss to $857,000, from $9.1 million in the same period last year. One reason: about 50,000 of TiVo's 104,000 new subscribers failed to redeem mail-in rebate offers, reducing the company's expected rebate expense by $5 million. TiVo says it generally sees lower redemption rates during the Christmas shopping season, when consumers may be too distracted to file for rebates on time.

Credit this bonanza for retailers and suppliers partly to human nature. Many consumers are just too lazy, forgetful, or busy to apply for rebates: Call it a tax on the disorganized. Others think the 50¢, $50—or even $200—is just not

SO IN THIS SECTION:

8 Trying to put the glaze back on Krispy Kreme

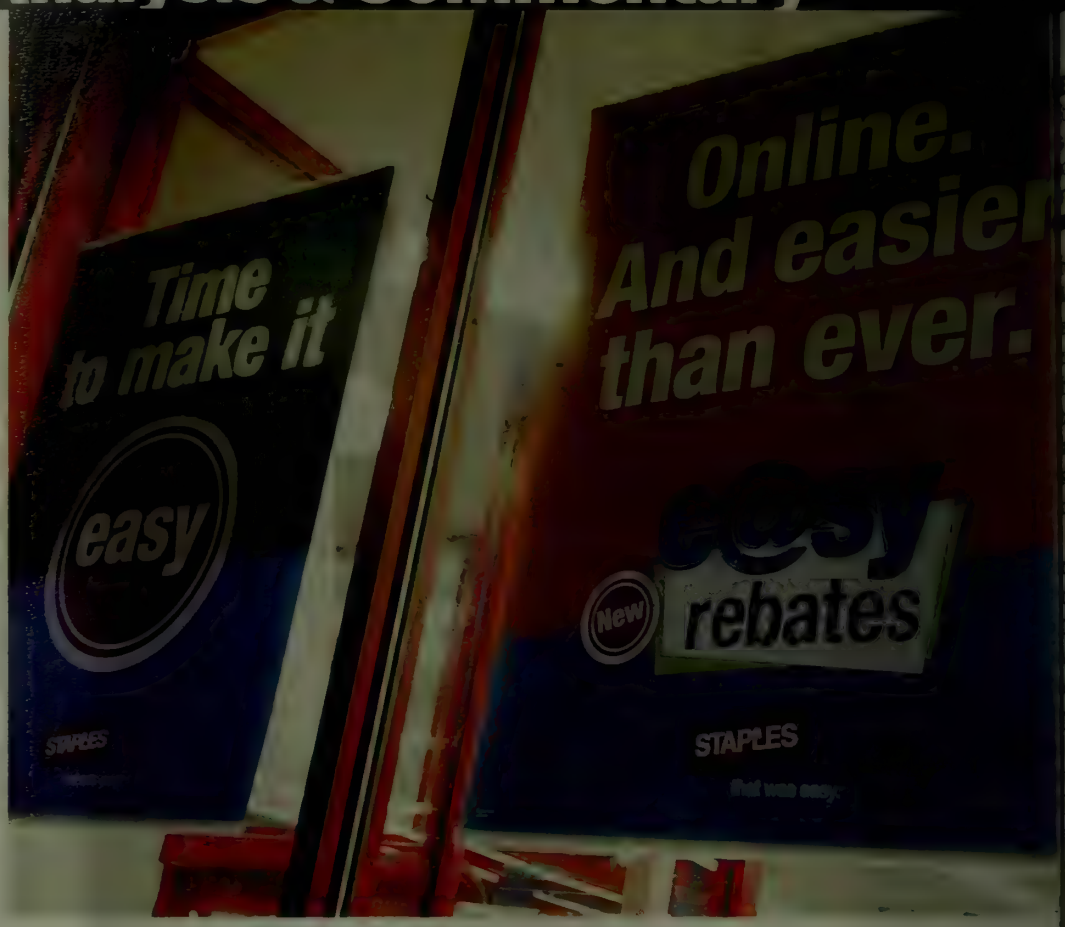
40 Predicting Merck's Vioxx liability is tricky

42 Warren Buffett is buying again

44 Racing to compete with Motorola's Razr

worth the hassle of collecting.

But many consumers—and state and federal authorities—suspect that companies design the rules to keep redemption rates down. They say companies count on complex rules, filing periods of as little as a week, repeated requests for copies of receipts, and long delays in sending out checks to discourage consumers from even attempting to retrieve their money. When the check does arrive, it sometimes gets tossed in the trash because it looks like junk mail.



"I WAS FROSTED"

THESE OBSTACLES don't stop Chuck Gleason. A rebate junkie, he has redeemed dozens of rebates on the high-tech and electronics gizmos he buys. But getting his money, he says, sometimes drives him crazy. On Nov. 7, 2004, for example, the 57-year-old director of operations for a Portland (Ore.) metal-recycling company bought a TiVo digital video recorder for $300. TiVo promised that a $100 rebate would arrive in six to eight weeks if Gleason mailed in his receipt and the universal product code on the box and kept his TiVo subscription for at least 30 days.

Gleason sent in the paperwork the very next day, and nothing happened. By February there was still no sign of his $100 despite repeated follow-ups, so he threatened to file complaints with state and federal officials. But TiVo's rebate processor, Parago Inc., left him even more exasperated: "Because your issue requires further research, your e-mail has been forwarded to a special team," said an e-mail from a customer-service agent named Sophie. Finally, on Mar. 29, more than 14 weeks after he bought his DVR, his check arrived. "I was frosted," he says.

Citing privacy restrictions, TiVo officials declined to discuss the case. But the company says it regrets any inconvenience and recently changed its rebate process to include a printable sign-up form at tivo.com to cut down on handwriting errors. Parago also declined to discuss the incident but said errors are rare among the "tens of millions" of rebates it processes each year.

Indeed, processors and companies offering rebates insist that there is no intentional effort to deny them, a move that Stinchfield, who is the chief executive of Orono (Minn.) consulting firm Promotional Marketing Insights, says would be akin to "brand suicide." Rather, companies say, the rules are aimed at stopping fraud. Rebate processors won't provide estimates for the amount of fraud they encounter, but Young America Corp., the nation's largest processor, says it now monitors 10,000 addresses suspected of submitting bogus rebates.

The quest for buyers who don't end up collecting a rebate has spawned special industry lingo. Purchases by consumers who never file for their rebates are called "breakage." Wireless companies that pay 100% rebates on some cell phones, for example, rely in part on "breakage" to make money. Rebate checks that are never cashed are called "slippage."

One processor, TCA Fulfillment Services in New Rochelle, N.Y., published a "Rebate Redemption Guide" for its corporate customers several years ago. It cited the low redemption rates that companie could expect after hiring TCA: just 10% fo a $10 rebate on a $100 product, and jus 35% for a $50 rebate on a $200 produc "If you are using another fulfillment com pany, add 20% to these redemptio rates," says the chart. Lewisville (Tex.) based Parago bought TCA's customer lis last December and disavows that guide. I says it can't estimate current rates becaus clients don't provide the company wit sales data. TCA founder Frank Giordan did not respond to several calls and a lette requesting comment.

Consumer-product makers such a Procter & Gamble Co. pioneered rebate in the 1970s as a nifty way to advertis small discounts without actually markin the products down. In the '90s, their pop ularity soared as computer makers an consumer-electronics companies pitche

How to Get Your Rebate

DON'T TOSS THAT BOX	KEEP THOSE RECEIPTS	MAKE COPIES OF EVERYTHING
» With most rebates, you must clip and send in the UPC codes printed on the packaging	» Nearly all rebates make you mail in the receipts—sometimes the originals—as proof of purchase	» Chances are there be a snafu and you m have to resubmit you application

ESPONSIVE Staples' online ystem cut vaiting time nd complaints

them as a way to move piles of PCs, cell phones, and televisions before they became obsolete. The value of rebates jumped, too, rom a couple of bucks to $100 or more. Vith more companies plugging rebates—nd more dollars at stake for consumers—omplaints have soared. Gripes filed with he Council of Better Business Bureaus ave tripled since 2001, from 964 to 3,641 ast year. But processors say that number is till tiny compared with the vast number of laims they handle.

David S. Bookbinder files many of the omplaints. Each year the 40-year-old omputer technician claims more than 00 mail-in rebates. He figures those deals save him—and customers of his omputer-repair business, Total PC Support, in Revere, Mass.—as much as $2,500. After eight weeks of waiting he usually calls customer service numbers to hunt down his check. If the representative alleges that paperwork was wrong or asks for more time, he automatically files complaints with the Better Business Bureau, the Federal Trade Commission, and the state attorney general.

Regulators are intensifying their scrutiny of the industry. In October, New York Attorney General Eliot Spitzer settled a case with Samsung Electronics America Inc. The company agreed to pay $200,000 to 4,100 consumers who were denied rebates because they lived in apartment buildings. Samsung's rebate program, according to Spitzer's office, allowed only one rebate per address, and the form didn't have a space to list apartment numbers. Samsung did not respond to requests for comment.

Meanwhile, in Connecticut, officials are investigating ads that list prices only after rebates—a marketing scheme prohibited in the state. Attorney General Richard Blumenthal won't disclose the names of the retailers. "If consumers are compelled to jump through hoops to receive the rebate or are denied rebates for illogical or arbitrary reasons, that adds fuel to our investigation," he says.

Some regulators are using novel tactics. On Nov. 7, Massachusetts officials filed suit against Young America to demand that it submit to an audit of $43 million in uncashed rebate checks. The company, headquartered in Young America, Minn., kept that amount of money from 1995 to mid-2002 in return for charging its clients lower fees, it says. Massachusetts officials believe that keeping uncashed checks could be an incentive to deny legitimate redemption claims. "It's almost like the old bait and switch," says Massachusetts State Treasurer Timothy P. Cahill.

NO INCENTIVE

YOUNG AMERICA IS fighting back. In written responses to questions from *BusinessWeek*, CEO Roger D. Andersen stands by the company's policy and says retailers and suppliers sometimes prefer that it keep uncashed checks. That keeps Young America from having to send them back and then turn around and collect its fee from clients. "Young America receives the same fees whether a submission is valid or invalid," he says. "We have no incentive to increase invalid rates."

The backlash against mail-in rebates is pushing some companies to drop them. Best Buy plans to phase them out in two years. At Staples, mail-in rebates were the No. 1 customer complaint for years, says Jim Sherlock, director of sales and merchandising. So a year ago, the Framingham (Mass.) company switched to an online system called EasyRebates that customers use to file for rebates and track their progress. Staples says waiting times for payments have been cut from about 10 weeks to as little as four, and rebate complaints dropped by 25%. "Breakage" also dropped by as much as 10%, but that decline in unclaimed rebates is offset by better fraud prevention, it says.

The fulfillment houses are also overhauling their systems. While it won't disclose figures, Parago says it has invested "tens of millions" of dollars in computer technology. So now, computers, not customer service agents, validate most of the claims. Then consumers receive e-mail updates and can check Web sites such as RebatesHQ.com to monitor claims. Before, says Parago Chief Financial Officer Juli C. Spottiswood, getting a rebate update was a "big black hole."

With billions of dollars at stake, bids to set uniform rules for rebates have met a ferocious response. Last year, California State Senator Liz Figueroa introduced a bill requiring companies to grant customers at least 30 days to apply for a rebate, mail checks within 60 days of receiving an application, and standardize the paperwork and personal data needed for a claim.

Telecom giants SBC Communications Inc. and T-Mobile and the California Manufacturers & Technology Assn. quickly mobilized. They argued that Figueroa's bill would drive up costs and increase fraud by cutting down on the proof required for a rebate. After passing the California House and Senate, the bill was vetoed by Governor Arnold Schwarzenneger. Now, Figueroa, a Democrat, is evaluating whether to reintroduce the bill in January. "This is an area where regulation is warranted," she maintains.

Despite the crackdowns and efforts at reforms, redeeming rebates will probably never be much fun. "In a perfect world, consumers would love mail-in rebates to go away," says Stephen Baker, director of industry analysis at NPD. "However, they want the best price that they can get. Those two things are fundamentally going to be at odds." ■

–With Rishi Chhatwal in Atlanta

Pocketing The Cash

Eager to win business from retailers and vendors, some fulfillment houses have cited their low redemption rates. Here's what TCA Fulfillment once pitched:

PRODUCT PRICE	REBATE	REDEMPTION RATE
$30	$30	50%
100	10	10
200	50	35

Data: TCA Fulfillment

N'T DELAY	BE SURE TO FOLLOW UP	SORT THE MAIL CAREFULLY
fter the purchase you have as little as a k to send in the erwork	» It may take a complaint to shake loose your rebate check	» Checks can look like junk mail, so be careful not to throw them out

Data: Consumers Union, Ohio Attorney General's office, ConsumerWorld.org

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DOUGHNUTS

KRISPY KREME HAS THAT GLAZED LOOK

Even turnaround king Steve Cooper is having trouble reviving the chain

BY DEAN FOUST

TURNAROUND SPECIALIST Stephen F. Cooper has worked his magic at many companies, helping bankrupt bus operator Laidlaw International Inc. achieve investment-grade credit quality and giving troubled Federated Department Stores Inc. the financial muscle to hit the acquisition trail again.

But has Cooper met his match in a doughnut chain that was once the darling of Wall Street? In the 10 months since he took control as CEO of Krispy Kreme Doughnuts Inc., he's still struggling to get the troubled Winston-Salem (N.C.) chain back on its feet. Krispy Kreme hasn't filed a quarterly financial report since October, 2004. It is facing a mid-December deadline to remain in compliance with lenders and a January deadline to avoid being delisted from the New York Stock Exchange.

What's more, two franchisees have filed bankruptcy, and three others have sued. Worst of all, sales remain in a downward spiral. In an Aug. 10 filing, Krispy Kreme said that, for the fiscal quarters ended in April and July, average store sales fell 21% and 18%, respectively. Meanwhile, Krispy Kreme keeps closing stores. The chain, which earlier this year boasted 440 outlets, has shrunk to 349. Small wonder that its shares, which closed on Nov. 22 at $5.45—89% below its 2003 peak—remain among the more heavily shorted stocks on the Big Board.

Cooper remains upbeat about Krispy Kreme's prospects. In his first interview since his arrival last January, Cooper told *BusinessWeek* on Nov. 18 that none of the company's short-term challenges were insurmountable. He's confident the current lenders, who stepped forward with $225 million in April, will grant him time to fix the problems even if his auditors can't make enough headway on Krispy Kreme's backlog of missed earnings reports by the December deadline. "The lenders lent us the money without financials being available," says Cooper. "That gives you a sense of the value they see in Krispy Kreme."

Longer term, Cooper remains sure that Krispy Kreme will be a growth stock again, so much so that he agreed to take his "success fee" not in cash, but in 1.2 million warrants, convertible into shares at $7.75 apiece. Cooper says Krispy Kreme has not scratched the surface of what it can achieve overseas. Even in the U.S., he sees plenty of room to expand. "We are by no stretch of the imagination approaching the saturation point for our retail outlets," he says.

FALL FROM GRACE

Data: Bloomberg Financial Markets

Still, it's clear that Cooper has lowered Krispy Kreme's once lofty ambitions. Whereas previous Chief Executive Scott Livengood built expensive 4,000-square-foot "doughnut theaters," as he called them, where patrons could view freshly glazed doughnuts rolling down an assembly line, Cooper's ambitions are much more modest. Franchisees say that current management is looking to build more cost-efficient units that, at 1,500 to 2,000 sq. ft., are more akin to a small doughnut counter. Franchisees also say that Cooper & Co. intend to promote the sale of coffee, a high-margin item that accounts for 50% of Dunkin' Donuts Inc.'s revenues but just 10% at Krispy Kreme. "Things have finally started moving in the right direction," says John C. Metz, a Pennsylvania franchisee and Cooper fan.

Still, it's far from certain that Krispy Kreme can ever reclaim its former glory. Donn Vickrey, co-founder of Gradient Analytics in Scottsdale, Ariz., and one of the first researchers to set off alarms about Krispy Kreme, estimates the company is generating negligible cash flow from its operations—a figure somewhere between $15 million and a negative $20 million. He adds that Krispy Kreme could wind up taking a net loss this year of $100 million because of asset write-downs.

More broadly, Harlan Platt, a professor at Northeastern University who studies corporate turnarounds, notes that most highfliers find it difficult to recreate their old growth rate after crashing back to earth. "I give it a 10% chance that Krispy Kreme will ever regain the luster it once had," says Platt. "I put them in the same category as Hard Rock Cafe. They had their moment, but the lines are no longer out the door." ■

BusinessWeek online For an interview with Krispy Kreme CEO Steve Cooper, go to www.businessweek.com/extras

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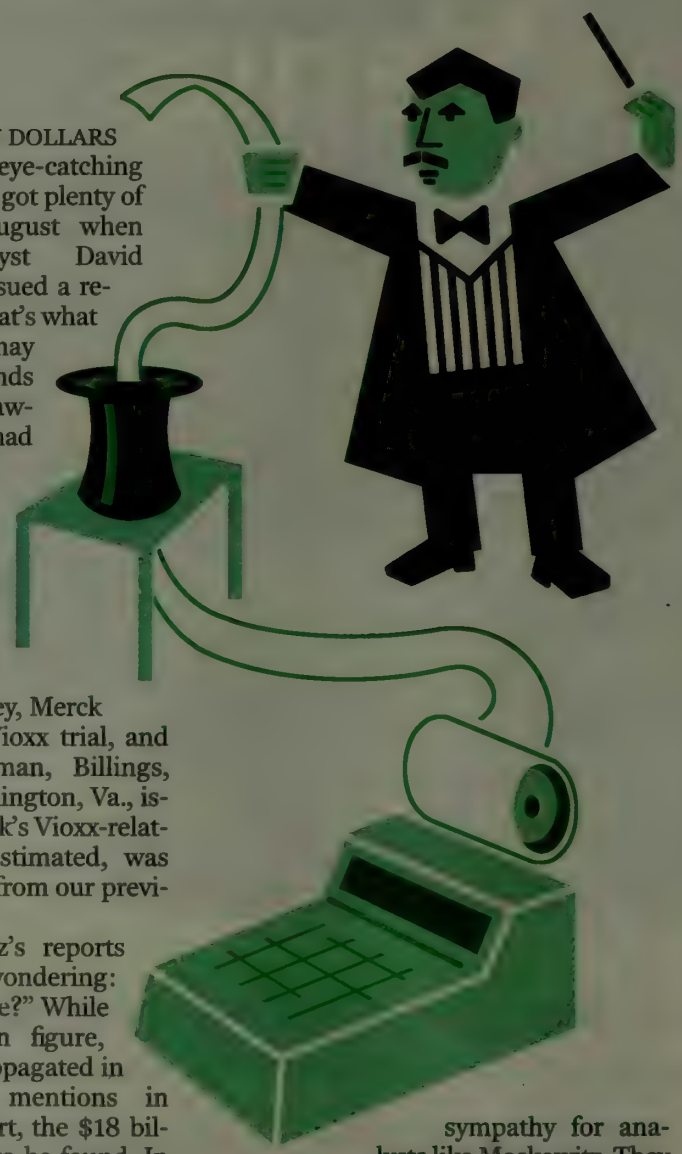
LAWSUITS

PRESTO: A NEW VIOXX LIABILITY ESTIMATE!

Why analysts' reports shift wildly with every twist in litigation against Merck

BY MICHAEL OREY



FIFTY BILLION DOLLARS is a pretty eye-catching number. So it got plenty of notice in August when stock analyst David Moskowitz issued a report saying that's what Merck & Co. ultimately may have to pay in the thousands of Vioxx personal-injury lawsuits it faces. A Texas jury had just handed the drugmaker a stinging defeat in the first lawsuit to go to trial involving the now-withdrawn blockbuster painkiller. Merck faced up to $26 million in liability for that case alone.

On Nov. 3 in New Jersey, Merck prevailed in its second Vioxx trial, and Moskowitz, with Friedman, Billings, Ramsey Group Inc. in Arlington, Va., issued his next report. Merck's Vioxx-related exposure, he now estimated, was about $12 billion, "down from our previous $18 billion estimate."

Readers of Moskowitz's reports could be forgiven for wondering: "What $18 billion estimate?" While the original $50 billion figure, quickly picked up and propagated in the media, got two mentions in Moskowitz's August report, the $18 billion number is nowhere to be found. In an interview with *BusinessWeek*, Moskowitz said the $18 billion estimate was "implicit" in his August report's target stock price for Merck of $25. He called the $50 billion "a high-end" figure, based on his view that Merck's liability "could fathomably" reach that level. But, he insists, "it was never our estimate."

Pity the investor trying to make sense of this. But perhaps reserve a dollop of sympathy for analysts like Moskowitz. They thought they'd be using their expertise in fields such as finance and pharmaceuticals to evaluate stocks—but now must try to factor in the arcane machinations of complex litigation. They have no choice. In recent years, Altria, Ford Motor, Firestone, Halliburton, Microsoft, and Research In Motion have all faced bet-the-company litigation that Wall Street can hardly afford to ignore.

Vioxx is just the latest in a parade o mass torts to march through the pharm sector. Merck voluntarily pulled the dru from the market on Sept. 30, 2004, aft one of its clinical trials suggested that could increase the risk of heart attack an stroke for certain people. On Nov. 29, th third trial involving the painkiller is set t get under way in federal court in Hous ton. Close to 7,000 Vioxx suits are on th docket and more are sure to follow.

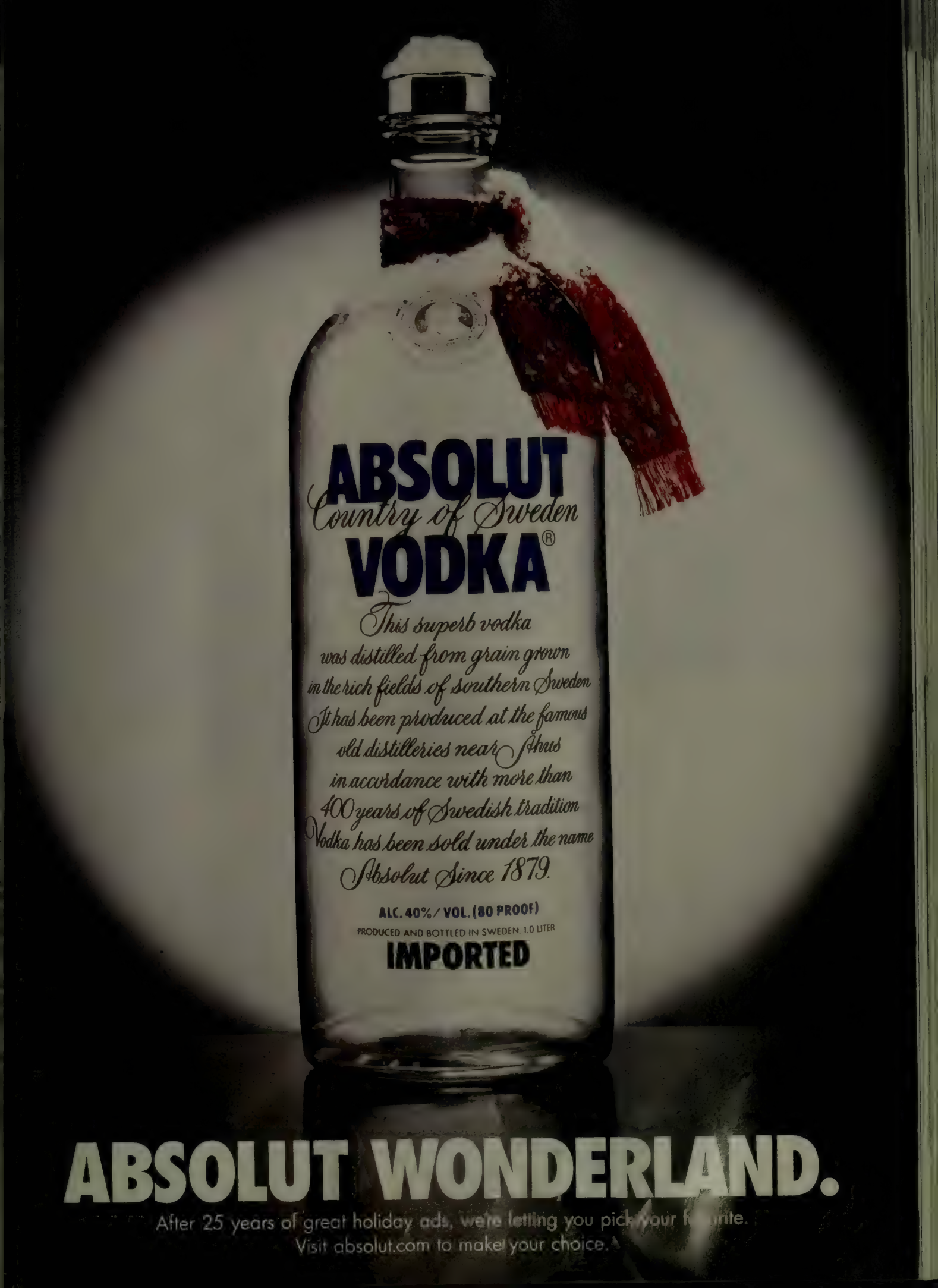
CHOCK FULL OF INTANGIBLES

THE SPECTER OF Merck facing suc massive potential liability sent man drug-industry watchers scrambling t project the potential tab. As quantitativ beings, analysts are hard-wired to loo for "metrics" that they can plug into ec nomic models and have a vision of the fu ture pop out. They are used to projectin a company's future earnings, for in stance, by assembling reams of data on it revenues, costs, and taxes. With litigatior they try the same approach, crunchin variables such as the number of possibl claimants and the likely size of a typica settlement or court award to produce so phisticated-looking reports packed wit calculations and charts.

But a close look at these estimates re veals that they are often based on num bers that are flawed, simplistic, or randor to the point of absurdity. Analysts als seem prone to making dramatic adjust ments to their calculations based on in cremental or inconsequential develop ments—such as the results of a singl trial. And no spreadsheet can capture th myriad intangibles that are so critical t the outcome of litigation, such as the evi dentiary rulings of a judge, the delibera tions of a jury, or the strategies and re solve of the opposing parties. That's a bi reason why the estimates in the past yea have variously projected Merck's liabilit at $5 billion, $10 billion, $12 billion, $1 billion, and $30 billion, not to mentior Moskowitz's chart-topper.

Two reports issued by Credit Suiss First Boston analyst Catherine J. Arnol in February illustrate how arbitrary an accordion-like investment houses' ap proaches to litigation analysis can be. Or Feb. 15, Arnold wrote that Merck's preta Vioxx liability "could approximate $1 billion," a number based on 96,00 claimants winning settlements or cour awards averaging $200,000. One weel

BusinessWeek online For more on how CSFB analyst Catherine Arnold estimated Merck's Vioxx liability, please go to www.businessweek.com/extras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later, Arnold slashed her estimate to $4.75 billion. Her reason: a vote by a U.S. Food & Drug Administration advisory panel that supported Vioxx's return to the market. (The FDA has yet to act on the recommendations, and Vioxx remains off the market.)

SLIPPERY BOUNDARIES

WHILE THE 17-15 vote was a narrow victory for Merck, the panel also suggested that the FDA consider limiting the direct-to-consumer advertising of Vioxx, that it be prescribed to a restricted patient population and only at lower doses, and that it carry a so-called black box warning—a prominent billboarding of potential hazards. The panel also agreed unanimously that data showed Vioxx significantly increased cardiovascular risk.

For some analysts, "I don't know" is not an option

Sanford C. Bernstein & Co. analyst Richard T. Evans concluded that the panel's actions left Merck's legal exposure unchanged, and, if anything, might help plaintiffs prove their case. But Credit Suisse analyst Arnold decided that the advisory body's deliberations highlighted evidence that would favor Merck and discourage litigants. She thus changed her estimated percentage of potential claimants who would actually file suit from 100% to 25%. Most recently, Arnold has raised that number back up to 50%, resulting in her latest liability projection of about $10 billion.

In an interview, Arnold acknowledges that the huge swings in her numbers might raise some eyebrows. "From a distance, it does seem peculiar to see these estimates go from one place to another." But, she adds, "we're in the early days of a very fluid situation and we're trying our best to put boundaries around it."

And both she and Moskowitz say they have no choice about trying to come up with estimates. "I don't think our job allows us the option of saying 'I don't know,'" Arnold says. But not everyone sees it that way. Deutsche Bank Securities Inc.'s Barbara Ryan, who has covered pharma stocks since 1982, says she has refused to offer an estimate for Merck's exposure because "it's a futile exercise." If you look at past estimates for litigation involving other products, she says, "they've all been off the mark." ■

STOCKS

WHAT'S IN BUFFETT'S SHOPPING BAG

He's making up for missed chances and stocking the liquor cabinet while staying mum on key stakes

BY ADRIENNE CARTER

FEW INVESTORS ARE WATCHED more closely than Warren E. Buffett, chairman and CEO of Berkshire Hathaway Inc. But The Buffett Show has been pretty boring in recent years. The budget-conscious sage was sitting on a $43 billion pile of cash at the start of the year, complaining that stocks were too expensive. As he told shareholders at his confab back in April: "If the market gets cheaper, we will have many more opportunities to do something intelligent with the money."

Now, it seems, the price is right. Berkshire's latest quarterly filings with the Securities & Exchange Commission show that it spent $5.7 billion on equities in the first three quarters of the year. At that rate, estimates Glenn Tongue of fund firm T2 Partners LLC, Berkshire's net equity purchases could hit $8 billion by the end of the year—a big jump from the $822 million total for 2004.

What is Buffett buying? One stock he's snapping up is Wal-Mart Stores Inc. Buffett has long lauded the giant retailer's management team and has said he made a mistake in not buying the stock in the late 1990s. Now it's just as cheap as it was back then, and in the last two quarters Berkshire has bought 19.9 million shares, worth around $874 million as of Sept. 30. Berkshire has also scooped up 44.7 million shares of Anheuser-Busch Cos., or 5.75% of the outstanding shares, since late last year.

SEC filings are of no help in deciphering the rest of Buffett's buying spree. In a recent report, Berkshire even says it's not disclosing the size of its current stakes in major investments H&R Block Inc. and Wells Fargo & Co. Under SEC rules, Berkshire doesn't have to reveal holdings publicly if that might hamper its investment strategy by, for example, indicating that it's buying or selling. Berkshire went silent on its position in Walt Disney Co. when it started selling out of the media company in the late 1990s.

THE STAT

$5.7 BILLION

The amount of money Berkshire Hathaway has poured into equities in the first three quarters of 2005

Data: SEC

But according to its latest filing with the National Association of Insurance Commissioners, Berkshire—through its GEICO and General Reinsurance Corp. subsidiaries—added 20 million shares of Wells Fargo in September, upping its holding to 76.4 million, or just under 5% of the stock. It also bought 15 million shares of European liquor company Diageo PLC in August, according to the filings.

DOLLAR POP

MEANWHILE, Buffett has been taking flak for his bet against the U.S. dollar, now around $16.5 billion. He jumped into foreign-currency derivatives back in 2002, believing that the mounting U.S. trade deficit would hurt the dollar. But this year that investment is down $897 million as the dollar has risen against the euro and other currencies. Overall, though, Buffett's foreign-currency holdings are up $2.1 billion since 2002 and gained $29 million in the third quarter, notes Berkshire's quarterly report.

For Buffett watchers who have been sitting on the sidelines, Berkshire's latest moves provide plenty of opportunity to jump back into the game. ■

THE I'M TIED TO MY DESK ERA IS OVER.

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CELL PHONES

THE LEADING EDGE IS RAZR-THIN

Motorola's cool phone has Samsung and other rivals in hot pursuit

BY ROGER O. CROCKETT

BACK IN THE FALL OF 2003, Chris Arnholt, a designer at Motorola Inc., pushed the company to buck a growing trend. While most phones were getting plumper to pack in cameras and stereo speakers, Arnholt and top company executives wanted to become what they called "the kings of thin." The result: the wildly popular Razr, introduced a year ago. Barely a half-inch thick, with sleek lines and a shimmering keypad, it has become the must-have phone for actress Mischa Barton, celeb Denise Richards and more than 12 million cell-phone users across the globe. "It's like driving a Mercedes vs. a regular ol' ride," said hip-hop mogul Sean "P. Diddy" Combs earlier this year.

HALO EFFECT

WELL, IT'S TIME to check the rearview. Rivals are coming on fast with their own trim mobile phones to take on Motorola's pacesetter. Korea's Samsung Electronics looks to be the most aggressive. By the first week in December, Sprint Nextel Corp. is expected to start selling Samsung's A900, a similarly svelte clamshell phone. No mistaking Samsung's intentions: The phone was originally codenamed "Blade." Meanwhile, Samsung is providing T-Mobile USA with a skinny slider phone, which has a keypad that slips down from behind the screen. And No.1 phonemaker Nokia has introduced in the U.S. its 8801 phone, another sleek slider. The company says it has been selling briskly overseas.

Yes, thin is in. And the trend will continue into next year. In the first quarter, Motorola plans to debut its Q phone, a razor-thin device designed to compete with the popular BlackBerry for the e-mail addicted. The company also has a new slender candy bar phone, dubbed the Slvr (for sliver), that should be available from carriers in the U.S. by early next year. Samsung plans a candy bar model too, just a third of an inch thick, by the end of March. "Throughout our entire line we will make products slimmer," says Peter Skarzynski, Samsung USA's senior vice-president for mobile phones.

There's more at stake here than meets the eye. Cool phones create cachet for the companies that make them. Top brass throughout the industry have noticed how the Razr's sex appeal has had a halo effect at Motorola. Although the company still trails Nokia by a wide margin, Motorola is on a tear like no other player in the business, boosting its market share from 13.5%, when the Razr was introduced a year ago, to nearly 19% this year, according to researcher Gartner Inc. "It acts as a catalyst for users to become more familiar with the brand," explains Richard S. Siber, CEO of wireless advisory firm SiberConsulting. "So familiar they actually request the brand."

That's one reason Samsung is striving to repeat its performance of a decade ago. After Motorola introduced the StarTac, the first pocket-size clamshell phone, Samsung followed suit by improving the design. It gave users a bigger screen by moving it from the bottom to the top of the phone and introduced color. Motorola was slow to respond, and Samsung gained swaths of market share.

Now Samsung is trying to get the drop on Motorola with new features and designs, including a thin clamshell that can handle television. The Sprint phone will operate on Sprint's high-speed wireless network, allowing users to watch live TV from the NFL Network and Fox News. "The service is a key differentiator," says Jeffrey D. Hallock, vice-president of product marketing at Sprint Nextel. "It's a great alternative [to the Razr]." Meanwhile, Motorola hopes to have a similarly featured Razr on Verizon Wireless shelves before yearend.

Motorola CEO Edward J. Zander makes no secret of his strategy to maintain momentum. He says the company is planning a host of variations on the original silver Razr, including reddish-pink and blue versions for the holidays. "The Razr has done more than just sell our product," he says. "It's got customers around the world looking at Motorola and saying, 'Hey, they're creative and cool and sexy again.'" The thin-and-colorful approach works in some circles. Actress Richards went for hot pink. ■

MISCHA BARTON *The OC* actress is a devoted Razr user

BRAND-NEW AND BARELY THERE

MOTOROLA SLVR This sawed-off version of the Razr is already available in India. Cingular is a good bet to carry it in the U.S. **Expected price:** $199 with contract.

NOKIA 8801 The slender stainless-steel slider phone is less than 2 in. wide. **Price:** The status-conscious can buy it at NokiaUSA.com or NiemenMarcus.com for $899

SAMSUNG A900 This jet-black clamshell number for Sprint Nextel is Razr-like and even offers live TV. **Expected price:** $199 to $299 with contract.

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BY RICHARD S. DUNHAM AND JOHN CAREY

The Sickening Politics Of Vaccine Legislation

EVEN IN AN ERA OF HYPER-PARTISANSHIP, it should have been easy. Everyone on Capitol Hill, Republican and Democrat, understands that the U.S. needs emergency legislation designed to speed production of new vaccines aimed at combating future pandemics. Everyone knows drugmakers need a liability shield to protect against the lawsuits that will inevitably spring up when a vaccine is rushed to market. And nearly everyone wants Washington to help Americans who are injured by their shots.

But in Washington nothing is easy, especially when it involves a clash between two bitter enemies—Hill Republicans and the trial lawyers. The GOP and pharma lobbyists charge that the lawyers and their allies are pulling out all the stops to prevent any erosion of their cherished right to sue at the drop of a hat. But the plaintiffs' attorneys see the Republicans pushing broad relief from lawsuits under the guise of public health. "It's cynical to claim that this is what's needed to deal with avian flu," says Senator Edward M. Kennedy (D-Mass.). "The Republican leadership is trying to do another favor for the drug companies."

Obscured by the overheated rhetoric, however, is a key issue: How much compensation should people damaged by these vaccines collect? Kennedy and the trial lawyers say they can support liability protections for drugmakers only if victims are promised full government indemnity. "We are not in any way trying to undermine the vaccine program," says Association of Trial Lawyers of America lobbyist Linda Lipsen. "In the event that individuals are injured [or] killed, there should be... compensation."

Full indemnity could be a trillion-dollar commitment, but that's completely impractical and unaffordable, Republicans say. During negotiations between Kennedy and Mike Enzi (R-Wyo.) on indemnity, Senate Majority Leader Bill Frist (R-Tenn.) summoned senators to his office to call off the talks. Indemnity will never fly, he said.

CLINTON She probably will accept a bill with limited liability protection

Vague Compensation

INSTEAD, INDUSTRY and Frist are backing an effort led by Senators Richard Burr (R-N.C.) and Judd Gregg (R-N.H.). They would limit liability to vaccines designated as essential to fighting pandemic flu or other deadly new diseases and would direct the Secretary of Health & Human Services to create a compensation program, with details and funding to be determined later. "We just don't have enough information to set one up now," argues a GOP staffer.

The pharmaceutical industry, not surprisingly, is firmly behind the GOP. Trial lawyers, advocates for vaccine victims, and others counter that a vague plan for a future compensation program is tantamount to none at all. Somewhere in the middle are public health experts. They want Congress to spur vaccine production while assuring the public it will have a safety net.

When all the smoke clears, that's likely to happen. Supporters plan to attach the Burr liability provision to a spending bill that just enough Democrats—especially those like Senator Hillary Rodham Clinton (D-N.Y.), who have already backed some form of liability protection—will be loath to oppose. It won't be pretty, it won't be easy, and it won't be truly bipartisan. But "it's all going to work out, despite the big bad trial lawyers," says a pro-industry lobbyist. ■

–With Lorraine Woellert and Eamon Javers

CAPITAL INSIDER

BUSINESS DIGS DEEP FOR PRO-TRADE DEMS

UNION LEADERS vowed to shut the fund-raising spigots for 15 House Democrats who broke ranks with their party in July to vote for the Central America Free Trade Agreement. But new Federal Election Commission reports indicate that business has more than compensated for labor's closed wallets.

A *BusinessWeek* analysis of political action committee receipts for the first nine months of 2005 finds that unions provided an average of 16.1% of the PAC money raised by CAFTA Dems—down from 22.1% in the 2004 election. But business donations surged to 76.7% of the CAFTA 15's PAC money, from 66.3% that these pro-business Dems received in 2003-04. Corporate interests have already pumped more than $100,000 into the coffers of 10 of the 15 Democrats.

Not much sting from Labor's CAFTA reprisal

Business efforts included a September fund-raiser hosted by leaders of the Business Roundtable, the National Association of Manufacturers, and the Electronic Industries Alliance. Bernadette Budde, senior vice-president of Business Industry PAC, says executives also will hold local events to make sure that Democrats "do not suffer for the [pro-trade] positions they have taken." First up: helping friendly Democrats such as Representatives Henry Cuellar of Texas and Gregory Meeks of New York, who face primary races against labor-backed foes.

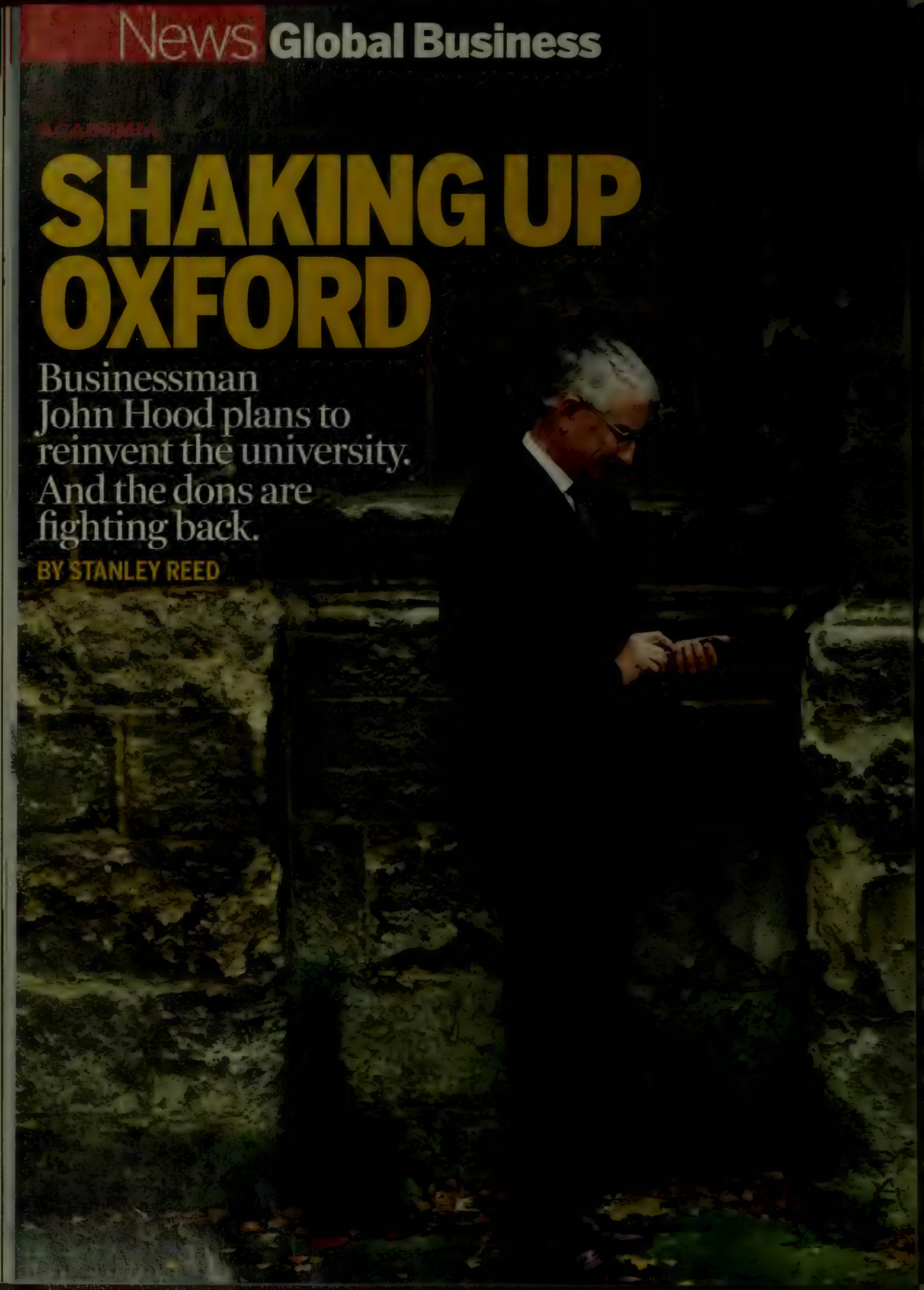
–By Richard S. Dunham

ACADEMIA

SHAKING UP OXFORD

Businessman John Hood plans to reinvent the university. And the dons are fighting back.

BY STANLEY REED



DARKNESS IS FALLING ON the stone buildings of New College, which despite its name is one of Oxford University's oldest institutions. The ethereal voices of the boys' choir, warming up in Latin for evensong, waft into the quadrangle, while in his comfortably cluttered rooms David Palfreyman, the college's bursar, pours gin-and-tonics. Palfreyman, who has published a series of books on university management, is one of many at Oxford on edge about some of the changes proposed by John Hood, the New Zealand-born vice-chancellor or chief executive. "Maybe we didn't do a good job of recruiting," Palfreyman muses about Hood. "Or we let him fall into bad company once he got here."

The object of Palfreyman's disquiet works in a plain office in the drab 1960s-style administration building. In an interview, the soft-spoken Hood shows flashes of the steely determination that made Oxford's search committee decide to hire him to give the place a top-to-bottom management overhaul. But Hood also seems humbled by the buffeting he has received from dons opposed to his plan. "I am here as the servant of the scholars," he says. "One has no power or authority in this job. One has only the power of persuasion."

Hood, 53, has a record of being persuasive. He had a long career in the top echelons of Fletcher Challenge Corp., one of New Zealand's biggest companies, before he left the business life to run the University of Auckland. "He did a near-miraculous job at Auckland," says a member of the search committee. In 5½ years, Hood turned around a conflict-ridden university, pushed for a new business school, and laid the groundwork for $500 million in investment in new facilities.

At Oxford, Hood has conceived a bold strategy to give the venerable institution the best shot at improving its standing in the globalized academic big leagues. Oxford no longer competes with Cambridge alone: It's pitted against such U.S. universities as Yale, Harvard, and Stanford for the best teaching talent and students. So Hood wants to boost the institution's $5 billion endowment and renew the dated infrastructure. Perhaps hardest of all, he wants to modernize the university's archaic governance, a step Hood considers essential if he is to convince megadonors that their money will be wisely spent. The goal is to turn Oxford into an international research leader across the board, and recruit not only the best British students and faculty but also the crème de la crème of the world—even if that means cutting the number of Britons.

It'll be touch and go, but most pundits say Hood should prevail. But what if he fails? Oxford has enormous intangible qualities that aren't a product of money. Most say, however, that without a shakeup a genteel decline will continue at what has been the world's premier educational institution throughout much of its 900-year history. "We are in real trouble" if Hood falls on his face, says W. Graham Richards, chairman of Oxford's chemistry department. One of Oxford's key modernizers, Richards, who recently raised $35 million from venture capitalists to help build a new $110 million chemistry lab, thinks Oxford badly needs streamlining and a more global outlook.

RADCLIFFE CAMERA

HIGH On Prestige, LOW On Dollars

	ENDOWMENT, IN BILLIONS
Harvard	$25.9
Yale	15.0
Stanford	12.4
Princeton	11.0
Oxford	5.0
Cambridge	4.6

Data: *BusinessWeek*

Yet Hood can't just order up changes to gird Oxford for the rigors of the 21st century. He heads a uniquely decentralized institution where power is held by a body of some 3,500 academics, administrators, and librarians, called Congregation. The university itself is a curious blend of a top-flight research institution and a conglomeration of some 39 autonomous colleges, which house undergraduates and provide much of their teaching. Some, like New College, date from medieval times; others are modern. Some are poor; others are rich. But together they control some 70% of Oxford's total endowment funds as well as undergraduate admissions. Behind high walls and gates manned by porters, they fiercely guard their independence.

While in practice Congregation rarely meets, any two members can call a vote, as they did in May when the group overwhelmingly rejected Hood's proposal for mandatory faculty performance reviews. Opposition is also brewing over plans to build a massive new facility to house Ox-

VICE-CHANCELLOR Hood brings New Zealand fresh air to medieval cloisters

(OPPOSITE PAGE) HARRY BORDEN; (THIS PAGE) ELLEN ROONEY/ROBERT HARDING WORLD IMAGERY/GETTY IMAGES

ford's millions of books. No wonder Hood and his team are frustrated. Changing Oxford's culture will require "decades, not years," says Giles Kerr, a former finance director at medical-equipment maker Amersham PLC whom Hood has brought in as finance chief.

NOT HUNGRY ENOUGH

WITH OXFORD REMAINING one of the two most prestigious universities in Britain, many wonder why there's any hurry to change. Cambridge bests Oxford in some surveys, but few think any Continental European institution can touch Oxford. Admission slots at the university that has educated some 25 British Prime Ministers, including Tony Blair and Margaret Thatcher, as well as titans like Adam Smith and Christopher Wren, are in greater demand than ever. An Oxford education is still the best ticket to the upper reaches of British government and business. The individually tailored instruction that goes on in the colleges is superb. Says Eve Bugler, a second-year undergraduate at Keble College: "The tutorial system stretches you academically because there is no way to hide."

What's more, even before Hood arrived, the university was starting to show some signs of business acumen. Oxford professors used to sneer at the idea of mixing academics with trade, "but that is not true anymore," says Michael Brady, an engineering professor who has founded several companies. Industry grants, intellectual-property licenses, and other collaboration with business brought in about $56 million in 2003-04.

For all its excellence, though, some professors say Oxford falls short of top rivals such as Harvard and Massachusetts Institute of Technology. "There is a lack of aggression, of hunger for that really big prize," says John March-Russell, a young Oxford professor of theoretical physics who received his doctorate from Harvard and taught at Princeton's Institute of Advanced Study. At the same time, the colleges feel threatened by the rise of the hard-sciences, which require big, expensive laboratories rather than medieval cloisters.

HEAVY ON TRADITION Honorary degree candidates in procession

The government, Oxford's main source of money, is forever raising the bar for greater egalitarianism in admissions. Teachers are poorly paid: A full professor's salary is $88,000 before a possible bonus, compared with $163,000 at Harvard. Oxford's faculty members also feel deluged by a flood of paperwork. "I think there is a good deal of unhappiness and tension about the place," says Robin Butler, a former Cabinet Secretary, Britain's top civil servant, now master of University College.

Few disagree with Hood's contention that Oxford needs cash. Its endowment is leagues behind Harvard's $25.9 billion (table). At the same time, Oxford's dependence on the government puts the university in a fiscal straitjacket. Funding of undergraduate teaching and research does not come close to covering the costs, yet the government mandates extremely low caps on the fees Oxford can charge undergraduates. That means students from wealthy backgrounds get a top education almost free of charge. Top fees are currently about $2,000 per year and are set to rise to about $5,150 next year.

Still, the university estimates it loses $12,000 to $14,000 per year on each British or EU undergraduate. Financial infusions of more than $419 million over the past eight years from lucrative Oxford University Press have been needed to help make up the deficits.

Because Oxford and Cambridge are so central to the British Establishment, they are the subject of endless scrutiny and debate. Many among the wider Oxford community think the university should declare itself independent from the government so that it could charge higher tuition. Another idea is to sell off Oxford University Press, which made $128 million in profits last year, to raise an endowment kitty. Hood shrugs off such thinking as "seriously flawed." To replace the $350 million or so a year that Oxford gets from the government, he says, would require $8.6 billion in endowment funds alone, assuming a 4% interest rate.

The financial pain is felt across the university. Oxford, according to a study by Palfreyman's OxCHEPS consultancy and the Ulanov Partnership, spends only about one-third what Harvard and Princeton do per student. Despite all its charms, Hood concedes, Oxford has a tough time luring faculty members that top U.S. universities want to retain. "Of course we have a major problem with funding," he says.

To help him reach his goals, Hood has hired Oxford's first development director, Jon Dellandrea, from the University of Toronto, where he was considered Canada's top fund-raiser. Dellandrea plans to oversee a quantum increase in fund-rais-

BIO

John Hood

Taking the mantle as Oxford Vice-Chancellor in a traditional New Zealand gown

AGE 53

JOB Vice-Chancellor, Oxford University since October, 2004.

PREVIOUS JOB Vice-Chancellor, University of Auckland.

EXPERIENCE 18 years with New Zealand conglomerate Fletcher Challenge. Headed paper and construction businesses. Headed University of Auckland, where he pushed for a new business school and helped raise $500 million for new facilities.

EDUCATION BE and PhD, civil engineering, University of Auckland. Rhodes Scholar, Oxford.

FAMILY Married, three children.

ng to pay for, among other things, a new humanities campus that Hood wants to build at a cost of more than $1 billion on the 10.5-acre site of the Radcliffe Infirmary, a hospital complex near the university.

Dellandrea maintains that "Oxford is the best brand in the world," yet he knows he faces a huge challenge. While Britain has grown much wealthier in the past two decades, the ranks of its superrich are still dwarfed by those across the Atlantic. Moreover, British tax laws does not give such favorable treatment to philanthropy as America's. As a result, says John Lippincott, president of the Washington-based Council for the Advancement and Support of Education, British universities "lack a culture of asking."

That's about to change at Oxford. Dellandrea plans to launch a badly needed campaign in the next 12 to 18 months to reach out to potential donors. Those Oxford colleges willing to disclose their fund-raising levels report only an average of 13% of alumni contributing, compared with close to 50% at Harvard and around 60% at Princeton. Hood says Oxford raises only an average of $120 million to $140 million a year from private donors, vs. several times that at some top U.S. players.

While just about everyone at Oxford welcomes the prospect of more money, some of Hood's other forays have caused friction. The most bitter battle came over his proposal to introduce mandatory reviews of staff "with scope to enhance financial rewards, rebalance academic duties, and address underperformance."

What's more, Hood wants to use reviews to improve career guidance for younger professors. Performance reviews, of course, are normal at corporations. Yet to many dons, Hood's plan looked like a punitive ploy to weed out faculty and cut costs. "Academic work is not something you do because someone is whipping you on the back," says one. The proposal was voted down by a huge margin by Congregation in May, a damaging early loss.

CONTENTIOUS

HOOD'S IDEAS FOR REFORMING the university's constitution have also been contentious. At present the highest body at Oxford is the 28-member Council, which is mostly drawn from the faculty-dominated Congregation. Hood has proposed dividing the Council's powers among two boards. An academic council would rule on scholarly matters. A 15-member group made up of seven outside trustees and seven insiders, chaired by University Chancellor Chris Patten, would have responsibility for broad strategy and finances.

The opposition isn't satisfied. The proposals would not help to restore "the severely damaged trust of Oxford's academic community," says a document from a group called "Democratic Governance." The group fears Oxford's creative environment, which they say is more important than pay, will be snuffed out by top-down management. Even some Hood supporters think he has moved too fast. "Hood hasn't played his cards very well," says Richards. "He started off acting [like] the CEO of a large corporation."

Will Hood be able to pull off a major restructuring of one of the world's oldest institutions? "I think he is going to take Oxford all the way," says Anthony Smith, the recently retired president of Magdalen College. "He knows where Oxford needs to place itself in the world." He'll certainly need a thick skin to get there. ■

–With Maha Aziz in Oxford and William Symonds in Boston

Fixing OXFORD

Means relying mainly on the power of persuasion

PROBLEM...	SOLUTION...
Funding shortfalls; not enough firepower to compete with U.S. rivals.	Boost endowment through major fund-raising drive. Look for ways to improve investment return on endowment. Lobby government to increase funding.
Infrastructure badly in need of repair.	Build new humanities campus at a cost of up to $1.5 billion. A new library with up to 8 million books is also planned.
Current decision-making bodies are unwieldy and lack independence.	Shift power to a 15-person Council with seven outside and seven inside members, in addition to the Chancellor.
Access to the university is still class-bound and narrow.	Boost scholarships available to needy undergraduates to as much as $7,000 per year for living expenses, the most generous levels in decades.
Professors see themselves as above accountability and scrutiny.	Set clear evaluation standards, even though the university parliament has rejected compulsory reviews.

KOREA

BMW, MERCEDES—AND HYUNDAI?

Not quite, but the auto maker is gunning for the luxury market

BY MOON IHLWAN

AMID THE CURRENT spate of riches-to-rags tales in the auto industry, Hyundai Motor Co. stands out for moving in the other direction. Since 1999, Korea's largest carmaker has transformed itself from a target for late-night comedians into a global leader in quality. In the process, the company has grown faster than any other major auto maker, setting up factories worldwide, including its first U.S. plant—in Alabama—in May.

Now Hyundai is hitting the accelerator again. Aiming to shed forever its image as a builder of crude econo-boxes, Hyundai in December plans the American launch of the Azera, the most expensive car it has ever sold in the U.S. "It is the first model for our metamorphosis," says Kim Jae Il, senior executive vice-president for overseas business.

STRESS ON SAFETY

WILL ANYBODY WANT a premium Hyundai? Company executives think 40,000 Americans will buy Azeras next year and 100,000 will do so the year after. The sedan is expected to go head-to-head with Toyota's Avalon, Nissan's Maxima, and Ford's 500. But with sticker prices topping out at $30,000, the Azera will come in anywhere from $1,600 to $4,000 lower than its rivals. Hyundai plans to offer oodles of upscale extras as standard fare—and hopes to make a name for itself as a leader in safety at the same time. Safety will be "a key part of our DNA," says John Krafcik, vice-president for development and strategic planning at Hyundai's U.S. sales subsidiary.

Take the Azera. The base model is equipped with extras normally reserved for the high end—eight air bags, electronic stability control, a traction control system, rain-sensing wipers, a six-CD changer, and a power rear sunshade that retracts when the driver puts the car into reverse. To give the Azera more oomph, the auto maker developed a 3.8-liter aluminum V6 engine, which Hyundai says will rocket the sedan to 60 miles per hour in 6.5 seconds—on par with many luxury sedans. And the car's cabin is room than those of the Avalon, the Merced Benz S-Class, and BMW's 7 Series.

The Azera, though, is only the begi ning. In 2007, Hyundai will roll out a tr luxury model, with a U.S. debut the f lowing year, possibly under an upmark nameplate like Toyota's Lexus or Hond Acura. The car, code-named BH, will the Korean auto maker's first rear-whe drive sedan and will boast a powerful 4. liter engine to make it a rival of the BM 5 series. "We still have to overcome a pe ception problem, but we have confiden in our new lineup," says Brandon Ye Hyundai's marketing director.

Critics say it may be tough f Hyundai to break into the luxury se ment. While moving upmarket is smai "I don't see Hyundai competing head-c with the likes of BMW anytime soon says Park Sung Jin, an analyst at Hannu Investment & Securities in Seoul. Son also wonder whether the move towar bigger cars makes sense as oil prices sk rocket. Hyundai executive answer that the new mode will be snapped up by cus tomers trading down fro even bigger gas guzzlers.

Hyundai is taking i sport-utility vehicles upma ket, too. The Tucson, whic was introduced in the U. last year, will cover the lo end of the segment, while revamped Santa Fe will b targeted at a more upscal clientele. The company o Nov. 22 unveiled the ne Santa Fe in Korea and ex pects to introduce it in th U.S. next year. The SUV which is roomier and mor expensive than today's mod el, is aimed squarely at Toy ota's Highlander. The en gine is 20% bigger than th current Santa Fe's, while th styling was changed from rugged look to sleeker line designed to appeal to socce moms. And like the Azera the new Santa Fe has numerous air bags, electronic stability control, antilock brakes, and active headrests—all standard. What's the sticker price? About $24,000 to $27,000, compared with $25,000 to $31,000 for a 2006 Highlander. Hyundai may yet have the last laugh. ■

THE OOMPH FACTOR The Azera leads off Hyundai's upscale campaign

Upmarket—With Lots of Extras

Standard features on the base model Azera and Avalon

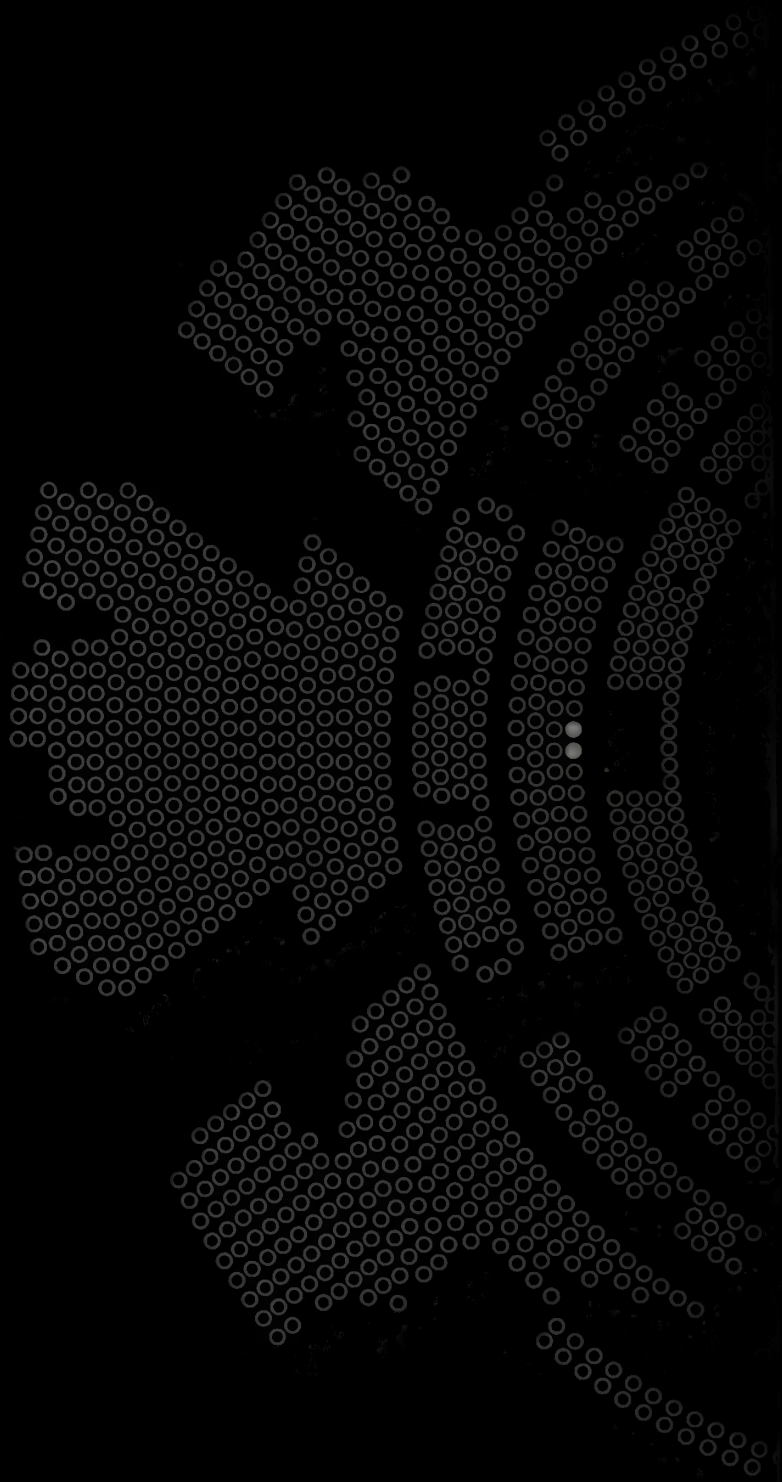
	HYUNDAI'S AZERA	TOYOTA'S AVALON
Engine	3.8-liter	3.5-liter
Four-wheel disk brakes	Yes	Yes
ABS brakes	Yes	Yes
Traction control system	Yes	No
Electronic stability control	Yes	No
Airbags	Eight	Seven
Alloy wheels	17-inch	16-inch
Power seat adjustment with memory	Yes	No
Audio	Six-disk CD, 10 speakers	CD, cassette, nine speakers
Price	Under $25,000	$26,625

Data: Hyundai Motor Co., Toyota Motor Corp.

A22 A23

GRAND TIER

THE ROYAL OPERA HOUSE, COVENT GARDEN, LONDON



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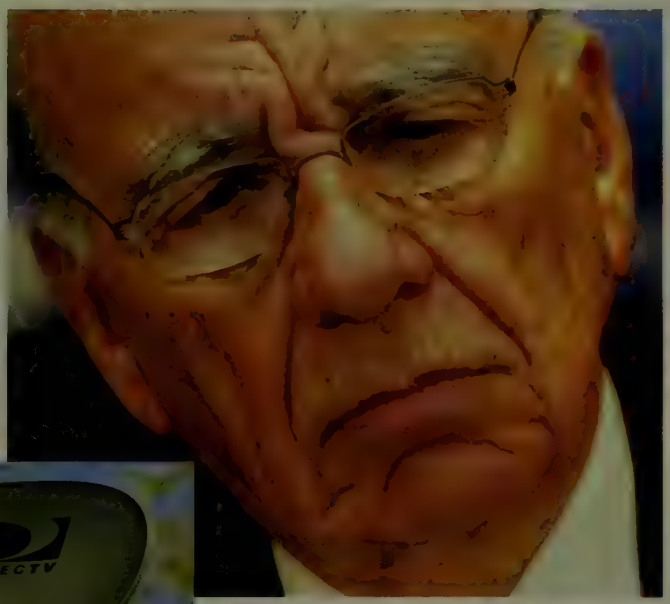
Static in Rupert's Satellite Dreams

New technology lets cable offer goodies DirecTV can't—and customers are noticing

BY RONALD GROVER

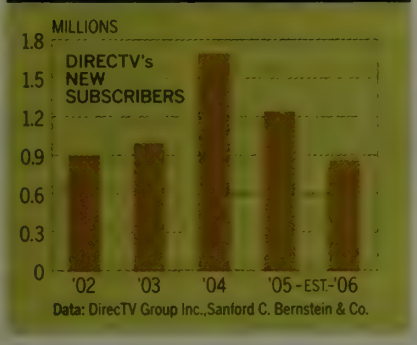
FOR RUPERT MURDOCH, gaining control of DirecTV was supposed to be the hardest part. When he finally won a 34% stake in the satellite operator in late 2003, the man considered by many to be the most powerful media executive in the world had finally closed the loop on his satellite empire. Now he would be able to offer cut-rate prices, provide cool services, and leverage his vast collection of movies, TV shows, and news to lure new subscribers. Murdoch put in charge 51-year-old Chase Carey, a former college rugby player with a handlebar mustache, to execute his plans to dominate programming and distribution. In Carey's two years as CEO of DirecTV Group Inc., the gruff-talking exec has delivered, siphoning off 2 million customers from rival cable operators, bringing DirecTV's total to 15 million.

What Murdoch didn't account for, however, was that in that same period the media world would be reordered by technology. Today his bid so quickly to make DirecTV No. 1 isn't looking like a cakewalk after all. For one thing, DirecTV has had problems sustaining the growth that made it a powerhouse rival in the first place. In the past six months it has added just over half as many subscribers as it did in 2004. And it pays a steep $626, on average, in promotions alone to win a new subscriber. That comes to about 75% of what that customer will pay in fees the first year. Moreover, DirecTV's churn rate—the number of folks who cancel their subscriptions—has risen to what Carey calls an "unacceptably high" level.



MURDOCH Spending big in an effort to blunt cable's momentum

TUNING OUT



Meanwhile, competition from cable has stiffened, and phone companies are joining the fray, too. After spending nearly $100 billion in the past decade to lay high-speed fiber-optic lines, cable outfits are rolling out services such as Web access, video-on-demand (VOD), and Internet phone calling, helping to keep subscribers from jumping ship. Time Warner Inc. and Cablevision Systems Corp. say they're adding new customers by bundling these services and even offering discounts—undercutting satellite's long-held price advantage.

RESHAPED LANDSCAPE

THE PROBLEM at the heart of DIRECTV's model is that it can't yet offer the two-way technologies that are so hot now—from Voice over Internet Protocol to VOD. Satellite's one-way feed can send shows to TVs, but there's no path back to the satellite, making its pay-per-view offerings much less popular since they start at scheduled times. Plus, cable is a more attractive platform for ads because it can target spots to specific neighborhoods. "Last year satellite had all the advantages. Now cable has attacked them on just about every one," says Craig E. Moffett, an analyst at Sanford C. Bernstein & Co.

Looming but still a bit distant are threats from phone giants Verizon Communications Inc. and SBC Communications Inc., which are gearing up to offer programming services. With its first trial under way in Keller, Tex., Verizon is offering a full menu of TV channels, part of a bundle with its own high-speed Internet services.

Murdoch, who doesn't take being No. 2 lightly, isn't blinking. DirecTV blames much of its slowdown in subscriber growth on an effort to weed out poor-paying customers. Even though it earned $215 million in the first three quarters of this year and its revenues increased 20% on higher rates, to $9.6 billion, DirecTV faces major expenses in the next year to keep pace with cable. It is already spending more than $1 billion to launch satellites to offer local channels in high definition. And advertising expenses for this year could top $200 million, a 30% jump over last year, estimates Merrill Lynch & Co. Numbers like those have turned investors sour: DirecTV's stock is down 18% in the past year, to about $14.

Meanwhile, cable is just warming up. On Nov. 2, three of the largest operators signed a deal with Sprint Nextel Corp. to

offer wireless phone service, enabling them to package yet another goodie into their promotions. Others are rushing to offer VOD, joining giant Comcast Corp., which offers a library of more than 4,000 TV show and movies, most of them for free. Despite losing customers in its most recent quarter, Comcast claims VOD and other services have helped it lure back so far this year 300,000 former customers who had defected to satellite. One market for other cable operators to emulate is Southern California. Cox Cable has signed up a third of its customers in San Diego and Orange County for TV, Internet, and phone service, leaving satellite's penetration in the area at just 14% of households, vs. a national average of 20%.

These new threats are reenergizing Rupert's crew. Using a key weapon—its exclusive deal to offer every Sunday National Football League game—it's marketing a screen with eight games playing simultaneously. To battle cable further, DirecTV will soon offer its own, slimmed-down version of VOD with 100 or so recent movies loaded ahead of time into a customer's set-top box. DirecTV has also announced that it will make some of NBC's hit shows, such as *Law & Order*, available for a fee on VOD. Still, "to me VOD is a lot of hype," says Carey. "The cable guys offer a lot of second-tier bulk. We're going to offer the ones that [customers] want."

DirecTV is looking for new partners to match cable's Internet and cellphone services. That would be taking a page from Murdoch's playbook in Europe. News Corp.'s 37%-controlled British Sky Broadcasting Group satellite service recently paid $363 million to buy Internet service provider Easynet Group and said it will offer wireless phone service via Vodafone Group.

Of course, DirecTV is still a huge jewel for Murdoch. Its mass audience, second only to Comcast's 22 million subscribers, is crucial to the mogul's ambitions to expand his Fox TV brand. He wants to use DirecTV to create a new cable outlet a year, such as the recent Fox Reality channel launched on the service, and as leverage to press cable operators to pay more for his existing channels.

But Carey knows that technology can be a game changer. "I don't think anyone is standing still," he says of the competitive landscape between cable and satellite. "They've moved forward, and so have we. We're not done." ■

Keeping the Whimsy Coming

How American Greetings helps its artists and writers stay inspired and in touch

FREE HAND Artists can exhibit at HQ and at an annual gallery show

BY JOSEPH WEBER

IS SANTA A PATRIOT? HE IS THIS year. If you go to a store run by American Greetings Corp., you'll see him on a Christmas card tucking miniature American flags into red, white, and blue stockings. Another card features a snowman waving the flag under the slogan "God Bless America."

While Christmas cards may seem like they've been the same forever, that couldn't be further from the truth. They are precisely calibrated to the national mood. The greeting card business, in essence, is the zeitgeist business. At 99-year-old American Greetings, the Christmas lineup is revamped every year, with slightly different shades of red and green and hipper colors tossed in—blues are hot now. "We are very focused on making sure we are ahead of trends," says Zev Weiss, 39, the fourth-generation chief executive of the Cleveland company. Jeffrey, who's his brother, is president.

To meet that challenge, the Weiss brothers create an environment that keeps the company's 400-plus artists, writers, and creative types inspired. After all, in a slow-growth business, constant renewal of design is what helps the company retain about a 35% share of the market, while Kansas City (Mo.) archrival Hallmark Cards Inc. leads with more than 50%. Analyst Jeffrey S. Stein of KeyBanc Capital Markets expects AG's sales to grow just 2% for the year ending in

ebruary, to $1.95 billion, even as productivity improvements drive up net income bout 23%, to $116 million. AG's sales remain less than half of those at privately eld Hallmark.

At American Greetings artists are encouraged to look inside and out for inspiration. The company's creative reference ibrary stocks some 10,000 books and provides 300 magazines, ranging from *Martha Stewart Living* to ultrahip publications such as style periodical *Zink*, plus a evy of animation magazines. To stay head of consumer tastes, AG relies on eedback from its 500 company-owned tores and powerhouse retailers such as Target and Wal-Mart Stores. Target, for instance, likes "fashion-forward" items such s gift wrap with holographic images and ards with lots of embellishments. In contrast, Wal-Mart's slightly older clientele warms to more traditional goods.

For Christmas themes a creative director travels to trade shows in Germany and England, checking out consumer sentiment in such seemingly far-flung areas as home décor. He even shops in luxury stores such as Harrod's. "Europe is a traditional source of fashion and design," says Vice-President Richard Hunt. Black and silver, now popping up in AG's Christmas lines, made their mark in Europe first.

LUNCHTIME MOVIES

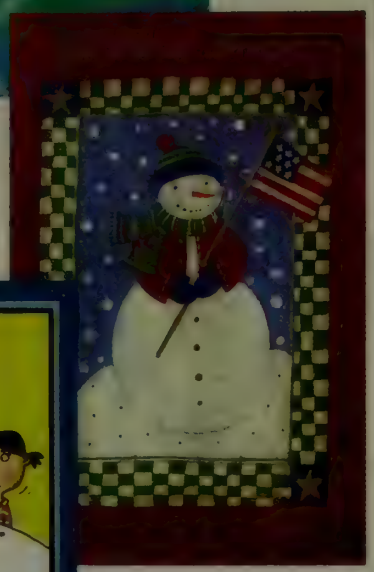
AT HEADQUARTERS artists can pick up creative vibes in a secluded room where the décor changes four times a year. The interiors have ranged over the past year from sleek ultramodern to comfy hunting lodge. The company also sends its artists on regular trips to local museums and art shows, and it hosts in-house sessions with top designers and floral experts. Writers go to poetry sessions and journal-writing classes. To get everyone in the mood for Christmas, AG brought in old holiday movies a few weeks ago, showing them at lunchtime. "They help us to be inspired," says Terrill L. Bohlar, a senior photographer at the company, adding that there's no penalty at AG for experimenting, including doing work that may fall short.

Recognizing that many of the artists do creative work outside the office, the Weisses accommodate them. They urge staffers to exhibit their off-hours efforts—nudes, portraits, and other formal work—in a gallery at headquarters, where the selection changes every three weeks. There's even an annual company-sponsored show at a Cleveland gallery.

Above and beyond supporting its artists, the company sucks all it can out of market research to help it get inside the heads of potential customers. For a few years its research with consumers has turned up a passion for such "feminine icons" as shoes, lipstick tubes, and hats, says Tina Benavides, a vice-president in the creative division. "This is part of a return to glamour," she says. Thus, one AG card reads: "Gloves and hats that match, a trendy scarf that ties—Christmas is a special time when girls accessorize!" Indeed, the female target is no accident: Women buy more than 90% of all greeting cards. AG's offices sport big banners with a photograph of a woman signing greeting cards along with the slogan: "It's all about her."

If the company is to stay on the cultural pulse, American Greetings clearly can't ignore the war in Iraq. That explains the patriotic Santa and snowman. Another card, addressed to "someone special who's serving our country," depicts a Christmas tree surrounded by stars. The message inside reads: Thanks for protecting "the greatest country in the world—a land of infinite opportunity and choices." On the other hand, perhaps befitting the company that has traditionally created the White House Christmas card for Democratic Presidents (Hallmark does the honors for Republicans), it also produces several cards that poke fun at President George W. Bush.

AG's artists will need all the inspiration they can glean to keep pace this Christmas season, since Hallmark could soon be the least of American Greetings' worries. Like every other communications business, AG is feeling the hot breath of technology. The company's artists now retool AG's products—and create new work—for DVDs, cell phones, and e-mail. The Weisses figure that paper cards, which account for just over half of annual sales, will never disappear. But AG is committed to staking out ground in all media. No matter how it delivers, though, the company's job remains the same: to keep the messages fresh. ■



2005 Lots of blue, support for the troops, and jokes about poker

PLAYBOOK: BEST-PRACTICE IDEAS

Get the **Juices** Flowing

At American Greetings, it is literally all about design. Management fosters a creative atmosphere by:

CODDLING TALENT Designers can retreat to a home-décor room at headquarters, lounging in a replica of a comfy hunting lodge or an ultramodern nest. (Designs change every few months.)

KEEPING CURRENT An expanding library of hundreds of magazines and thousands of books, many from Europe and other design centers, helps keep designers' imagery trendy.

LOOKING OUTSIDE Design honchos confer with tastemakers from disparate fields, from car companies to appliance manufacturers.

BusinessWeek online For a look at some of American Greetings' online cards, go to businessweek.com/extras

Cat Sinks Its Claws Into Services

Dirty, greasy work could help Caterpillar thrive during the next downturn

BY MICHAEL ARNDT

JENNIFER SOUTH AIMS HER needle gun at a busted-down engine and blasts away. The giant 12-cylinder motor had powered a mining truck until a few weeks earlier, when it was carted off to Caterpillar Inc.'s remanufacturing plant in Corinth, Miss., to be salvaged. Over its brutal life, the engine had become caked with dust that had hardened like concrete. Now, wearing safety glasses, earplugs, gloves, and a protective apron, South must chisel away the years of buildup to unearth a bolt so she can further dismantle the 17,800-pound carcass of iron and steel. The air-driven gun pecks, with rods that look like knitting needles, until the calcification is gone.

"It's oily, greasy, heavy work," says South, who joined the company nine years ago as a 19-year-old college student. And progress is slow. The plant's 600 employees disassemble and rebuild an average of just two diesel engines per eight-hour shift, cleaning, inspecting, and repairing 20,000 parts along the way. But multiply that output by Caterpillar's other remanufacturing plants—the company will start up its 14th, in Shanghai, in early 2006—and then multiply that by the five-figure price of these reclaimed products, and it gets easier to see why the division has become Caterpillar's fastest-growing unit this decade. Annual revenue tops $1 billion and is estimated to grow 20% a year.

This type of unglamorous, quintessentially Old Economy dirty work is how Chief Executive James W. Owens is planning to make Caterpillar a $50 billion company. His strategy: have service businesses refill the bucket when the current manufacturing gusher inevitably begins to slow.

CLEANING UP Worker South with a truck engine in Corinth, Miss.

A 33-year Caterpillar veteran, Owens, 59, ascended to the top job in early 2004. Since then his biggest problem has been simply keeping pace with the upsurge in demand for earthmoving equipment and heavy-duty engines. That "yellow iron," as Owens calls it, helped Cat place No. 23 on the *BusinessWeek* 50 tally of last year's best corporate performers. This year is shaping up even better: Owens says Caterpillar's 2005 revenue will increase 20%, to a record $36.4 billion, with profits climbing at least 37%, to $2.7 billion—an all-time high. The stock, which closed at $58.70 on Nov. 22, is up 21% this year, near its record high of $59.88 in mid-September.

The Best Performers

FROM BOOM TO BUST?

BUT CATERPILLAR'S basic business is extraordinarily cyclical, as Owens, a PhD economist, knows all too well. Behind today's turbocharged results, another industrial bust may already be in the offing. Owens foresees the domestic market for big-rig truck engines peaking in 2006. The mining sector will top out in 2009 if not sooner, he adds, with an outright recession possible as soon as 2011.

To offset the slowdown, Owens wants to make more acquisitions, particularly in fast-rising markets such as China, and to double the pace of new rollouts to grab market share. He's also pushing dealers to cut inventories. That would reduce orders now, but should keep factories busier when retail sales slacken. And for as long as demand holds up, he's hiking prices.

Services, however, are the key to Cat's strategic shift. The Peoria (Ill.) company has three service divisions today—Financial Services, Logistics, and Remanufacturing—which account for 15% of Caterpillar's revenues and perhaps 20% of its net income. Because of their fast growth, Owens says, they should generate 20% of sales by 2010, which would put the troika's combined revenues at $10 billion. Since these also are higher-margin businesses, their bottom-line contribution should increase even more, to as much as 30% by the end of the decade, calculates Ann Duignan, an analyst with Bear, Stearns & Co.

Cat Financial extends credit for three-quarters of all Caterpillar sales, so it has soared right alongside the equipment business. The division, which averages 95,000 customers a year, opened its first office in China earlier in 2005. No surprise, then, that it's having a record year, with expected revenues of $2.3 billion and a $350 million profit. Cat Logistics,

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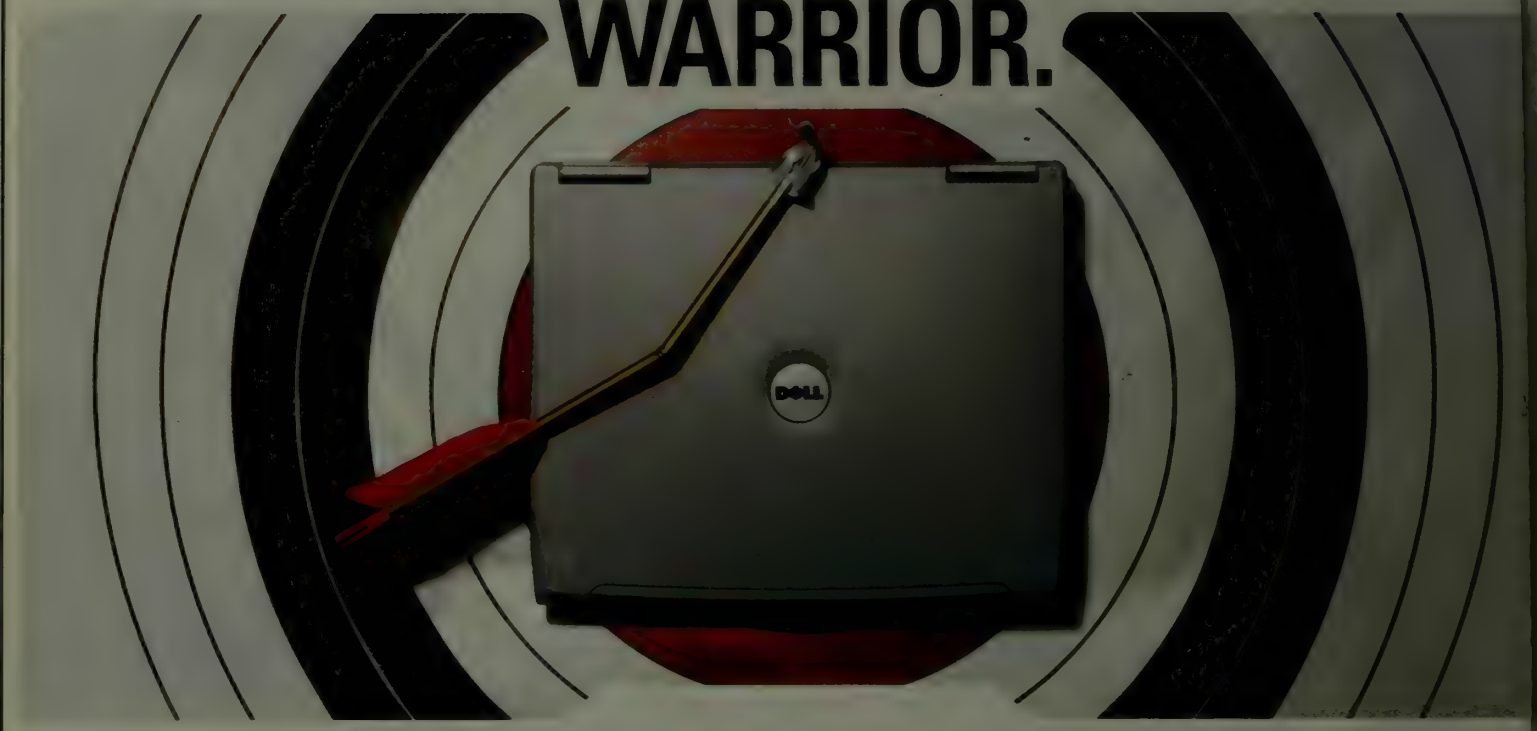

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meanwhile, is prized for its steady income stream. The unit warehouses and delivers replacement parts for 60 industrial customers, including Bombardier Inc. and Harley-Davidson Inc. In October it signed a $100 million contract with General Motors Europe that will pay out over a decade.

The remanufacturing division is the newest of the service units. Caterpillar got into the business almost by accident: It dates back to a favor Cat reluctantly did for Ford Motor Co. in 1973. To lower its own costs, Ford's truck-making subsidiary wanted a source of rebuilt engines, which generally sell for half the price of new ones. As Caterpillar executives tell it, management saw Ford's demand as a chore. But because supplying Ford with new engines would be such a money-maker, the company consented and opened a repair shop in Bettendorf, Iowa. By 1982 the business had grown enough that Caterpillar bought a vacant factory in Corinth, Miss., to reclaim used crankshafts. Still, even into the late 1990s, after Caterpillar built a second plant in Nuevo Laredo, Mexico, and a third in Prentiss, Miss., remanufacturing was considered a sideline. "It was something we had to do," recalls Steven L. Fisher, president of the division.

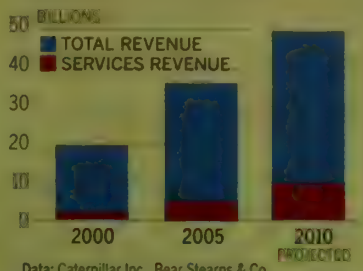
In 2000 management realized that this handful of ancillary factories represented a hidden opportunity. The business had become reliably profitable, and the marketplace was full of mom-and-pop outfits, making it easy for the company to pick up business through acquisitions. Caterpillar's own numbers argued for expansion, too. As new-equipment orders were falling amid a plunge in the industrial economy, revenues and profits from Caterpillar services continued to climb. Since then, as the company has built and acquired more facilities, Cat Remanufacturing's results have doubled.

The division's flagship plant in Corinth, about 100 miles east of Memphis, extracts every last bit of value from used parts. The facility, which is the size of six football fields, is a cacophony of industrial clangs and whirs as workers strip old engines down to their individual components and then, after salvaging whatever they can, put them all back together. No piece is too inconsequential for recycling. In the area where Jennifer South works, employees fill wire bins with bolts, nuts, and washers sorted by stock-keeping unit number. The parts are then cleansed in a bath of molten salt to come out like new.

Nor are damaged goods automatically tossed aside as scrap. Down the line, a computerized machine builds up a worn-down engine block by spraying it with a fine mist of liquefied metal. When it's done, the surface has been raised by the width of a dime. Other workers dust engine blocks, crankshafts, and other major components with a metal powder that, when magnetized and viewed under ultraviolet light, can expose otherwise invisible cracks. Like dentistry on a large scale, cracks then are dug out, and the cavities filled by hand with iron and machine-polished to original product specifications.

CAT'S HIDDEN ENGINE

Caterpillar's ambitious growth target is $50 billion in revenue by 2010. It plans to hit the mark with the help of its services divisions: Financial Services, Logistics, and Remanufacturing.



Data: Caterpillar Inc., Bear Stearns & Co.

ROOM TO GROW

ANALYSTS PRAISE THE UNIT because it also allows Caterpillar to profit again and again from the same goods. By selling rebuilt products at discount prices, it keeps makers of knockoff parts out of the lucrative aftermarket. And the business seems to have room to grow: Its Shanghai plant will let it offer rebuilt parts in China, a market that could be big, since few customers there can afford new equipment. Remanufacturing, says Owens, "has the highest growth and earnings potential of any of our businesses in the next five years."

Owens is confident of maximizing that potential. During the next contraction, he's promising that earnings won't drop below $2.50 a share, as they did in 2001 and 2002. The only way he can meet that commitment, says Bear Stearns' Duignan, is if his services strategy pans out as planned. ■

Worn-out goods, refurbished, may have more lives in them

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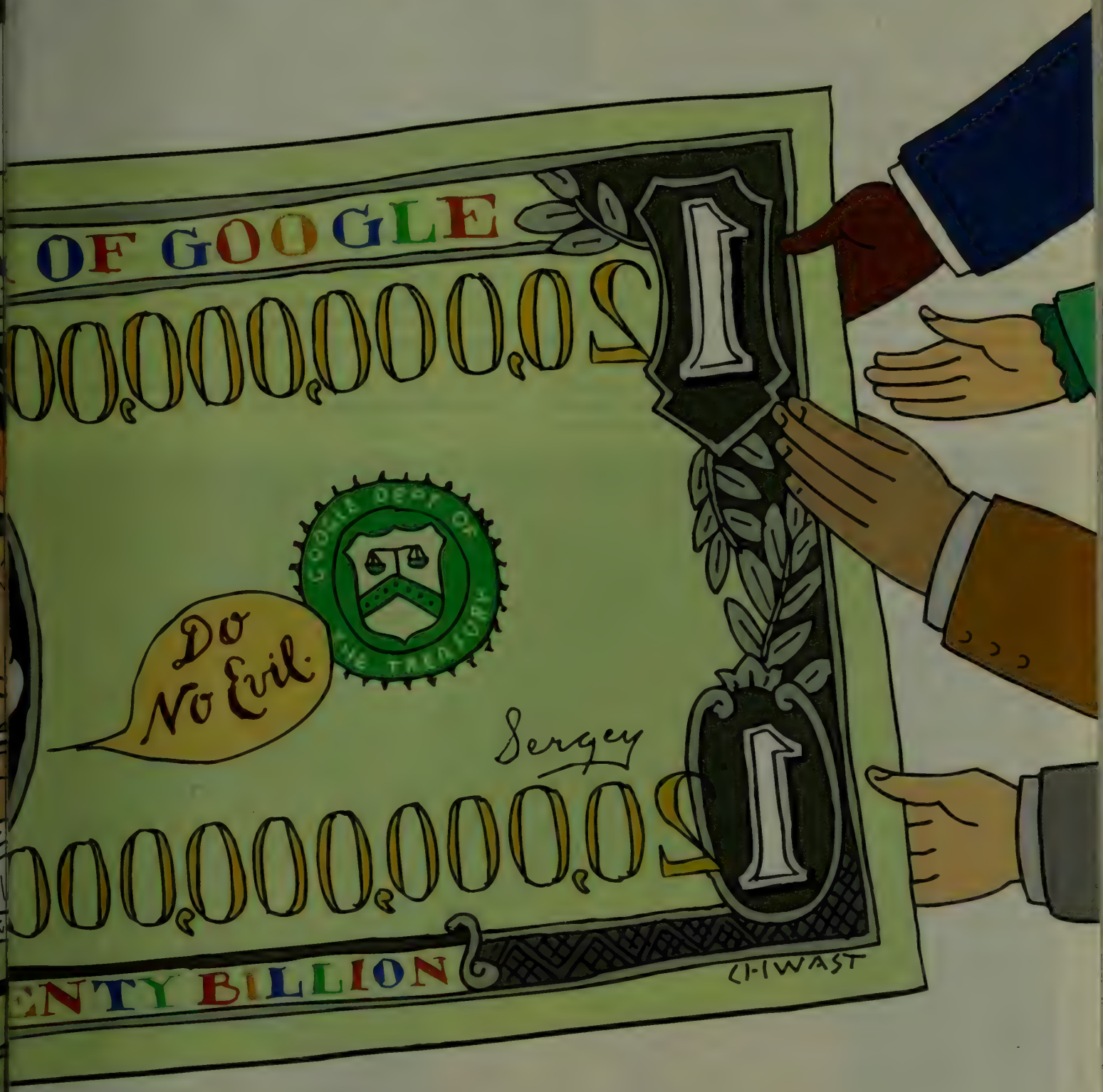
Googling

With a market cap in orbit and more cash than a small nation, Google is altering the tech industry's behavior. But when does its long-awaited shopping spree begin?

BY ROBEN FARZAD AND BEN ELGIN

SEYMOUR CHWAST

for Gold


OF GOOGLE
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ENTY BILLION
CHWAST

WITH THE NEWS THAT SHARES of online search giant Google Inc. had crossed the lofty $400-per-share mark on Nov. 17, the world may have witnessed something akin to the birth of a new financial planetary system. Given its market cap of $120 billion, double that of its nearest competitor, Yahoo!, Google now has the gravitational pull to draw in a host of institutions and company matchmakers unable to resist the potential profit opportunities. Google stock, with a price-earnings ratio of 70, represents one of the richest dealmaking currencies anywhere. That heft has attracted a growing galaxy of entrepreneurs, venture capitalists, and investment bankers, all of whom are orbiting Google in the hopes of selling it something—a new service, a startup company, even a new strategy—anything to get their hands on a little of the Google gold. "The dollars at stake are huge," says Geoffrey Baldwin, managing director at San Francisco investment bank Perseus Group.

The Google effect is already changing the delicate balance in Silicon Valley between venture capitalists and startup companies. Instead of nurturing the most promising startups with an eye toward taking the fledgling businesses public, a growing number of VCs now scour the landscape for anyone with a technology or service that might fill a gap in Google's portfolio. Google itself and not the larger market has become the exit strategy as VCs plan for the day they can take their money out of their startups. Business founders have felt the tug as well. "You're hearing about a lot of entrepreneurs pitching VCs with their end goal to be acquired by Google," says Daniel Primack, editor of *PE Week Wire*, a dealmaking digest popular in VC circles. "It's a complete 180 [degree turn] from the IPO craze of five years ago; now Google is looked at like NASDAQ was then." Other entrepreneurs, meanwhile, are skipping the VC stage altogether, hoping to sell d rectly to Google.

SHOPPING SMALL So far, Page and Br prefer embryonic, tech-focused startup

On Wall Street, the Google effect, while less profound, is sti clearly in force. All manner of investment banks, from gian such as Morgan Stanley and Credit Suisse First Boston to mic size players such as Allen & Co., have dispatched bankers t Google's Mountain View (Calif.) headquarters, the better t court the Google gatekeepers as they attempt to sell a raft o mergers and acquisitions, financings, and strategic advic Meanwhile, smaller boutique firms are trying to ride Google' considerable coattails, signing up the scores of increasingl valuable Web upstarts cropping up around Google.

There's one snag in this planetary realignment: Google ha shown little interest so far in doing big deals with anyon Although it briefly sniffed around Web-phone giant Skyp Technologies, Google blanched at the eventual price o $2.6 billion ponied up by eBay Inc. in September. In fac Google's biggest deal to date is the $102 million it paid for on line ad upstart Applied Semantics Inc. in 2003. For now, a least, Google is passing on big, bold deals. "They are floode with people trying to get in the door," says Rodd Langen hagen, managing director of Boston mergers and acquisition shop Revolution Partners. "But so far Google is just a grea potential acquirer." Adds tech banker Alec Ellison of Nev York-based Jefferies Broadview: "M&A is just not a very hig priority for them."

ILLUSTRATION BY ALBERTO MENA/BW

> We would fund projects that have a 10% chance of earning a billion dollars.... Do not be surprised if we place smaller bets in areas that seem very speculative or even strange
>
> *—From Google's IPO prospectus*

But if dot-com history is any indication, the risks of doing nothing could be substantial. Google could be sitting on an ephemeral asset. In 1999, Yahoo Inc., Google's closest publicly traded equivalent, had a $115 billion market cap but passed up the chance to buy eBay. Today, eBay is worth more than Yahoo, whose value has since nearly halved. At its 1999 height, Doubleclick, the big online ad player of yesteryear, had $14 billion in market cap. It didn't put it to work, though, and in April this year was bought by a private equity firm for just over $1 billion.

That's not to say Google could afford to go out and do a big deal just for the sake of it. A mega-takeover potentially could wreak havoc on Google. Even Piper Jaffray Co's. Internet analyst Safa Rashtchy, one of Wall Street's biggest Google bulls, says: "If they were to buy AOL or eBay, it would hurt the stock." Says David C. Drummond, Google's head of corporate development: "We're not going to manufacture opportunities solely because of the currency." (Although Google prefers not to comment on its dealmaking plans, it did make Drummond, as well as its investment bankers, available for some questions.)

All the same, the lure of a big deal could prove hard to resist, particularly if Google's strategic position is threatened. For the past two months, Google has been battling Microsoft Corp. at the bargaining table for a stake in Time Warner Inc.'s AOL unit, possibly through an expanded partnership or a joint venture. Google has all but owned the AOL relationship since 2002, providing both search technology and ads. AOL has meant big business for Google, accounting for 11% of its $2.6 billion gross revenues in the first half of this year. But perhaps more compelling to Google is AOL's access to reams of content owned by sister companies such as Time Inc. and cable channel HBO.

The negotiations are taking Google into uncharted territory. Some analysts value AOL's business as high as $20 billion, including about $12 billion for the coveted portal and search pieces. The search kingpin could prevail with an expanded partnership and shell out virtually nothing. But the fact that Google is still at the high-stakes table shows how much it could lose if AOL walks.

Such strategic contingencies weren't mapped out in the coy statements made in Google's prospectus when it first sold shares to the public 15 months ago. "We would fund projects that have a 10% chance of earning a billion dollars over the long term," wrote founders Sergey Brin and Larry Page. And then they added: "Do not be surprised if we place smaller bets in areas that seem very speculative or even strange. As the ratio of reward to risk increases, we will accept projects further outside our normal areas, especially when the initial investment is small." That's enough to give hope but not much direction to would-be partners and dealmakers.

Rainmakers at blue-chip investment banks are accustomed to a certain level of respect—something that Google is unwilling to grant automatically. Just ask Goldman, Sachs & Co. Goldman famously got the boot from the elite group selected to manage Google's IPO after Brin and Page caught wind of the firm's backroom lobbying of one of Google's largest VCs for a bigger stake in the deal. The bank has been trying to crawl out of the woodshed ever since. Goldman declined to comment.

"The First Inning"

IN FACT, BRIN AND PAGE HAVE made a sport of snubbing Wall Street since they co-founded the company in 1998. They've made it clear that Google plays by its own rules and values. Their August, 2004, IPO filing reads more like a manifesto than the usual drab financial boilerplate. And by masterminding the IPO as a modified Dutch auction, they thumbed their noses at Wall Street's traditional trust-us-and-we'll-handle-everything way of doing business.

Still, many bankers believe that in the new Google-centric universe, immense profits are to be made, even if Google itself remains tightfisted. "This is an investment banking gold rush," says Perseus' Baldwin, as he whips out a glossy pitch book and points to statistics illustrating massive changes in the world of advertising and media. Those trends may be led by Google, but they imply some wrenching tectonic shifts throughout the media world. And in those dislocations lies opportunity for

EPA PHOTOS

astute investors and dealmakers.

Last year U.S. advertising spending was an estimated $300 billion to $400 billion. Just $10 billion of that was spent online, even less than for ads in the Yellow Pages. By contrast, newspaper and direct telephone markets were worth five and nine times as much, respectively. Yet, according to Forrester Research Inc., households now spend at least 30% of their media time online, while the Internet has just 5% of total ad spending. That situation won't last for long. According to the Interactive Advertising Bureau and PricewaterhouseCoopers, online ad revenue grew 34% in the latest quarter, with total 2005 revenue on track to grow by 25%, to at least $12 billion; newspaper ad revenue, by contrast, is slated to grow less than 3% this year. Baldwin says that Perseus has a backlog of six portal and e-marketing transactions poised to benefit from this revenue reallocation in Google's wake, and is on pace to complete at least 30 deals in 2005, twice last year's tally.

Investment Bankers

With its $120 billion market cap and $8 billion in cash, Google is a magnet for mergers-and-acquisitions bankers. And its massively disruptive effect on the media market is putting a long roster of smaller outfits—from advertisers and e-marketers to Old Economy mainstays—in play, giving bankers lots of deals to hawk.

Google's own bankers have also seen the possibilities lurking in the company's $120 billion shadow. "You almost bank on other companies becoming successful because of Google," says banker Quincy Smith of Allen & Co., which represents Google. He points to Advertising.com, an e-marketing client that appeared on his radar when he noticed that 40% of its revenue came through Google. Allen & Co. helped sell the company to AOL for $435 million in June, 2004—demonstrating how even a dormant Google made the bank money. Another major Google banker hammered home the 5% online ad market share figure in a presentation to institutional shareholders interested in Google's $4.2 billion secondary share offering on Sept. 16: "I told them, 'Oh my God, we're just in the first inning. Advertising will be completely turned on its ear.'"

In the Silicon Valley food chain, the first to lay bets on which way things will shake out are the venture capitalists whose fate is now firmly entwined with that o Google. It's not a very comfortabl position for VCs, who view Goog with a mixture of disdain and env Googlers, as they're known—man of whom have emerged from thei company's remarkable increase i value with sizable personal for tunes—work in one of the cushies corporate campuses in the Valle There's the free cafeteria that wa started by Google's millionaire for mer chef, who used to work for Jerr Garcia of the Grateful Dead, as wel as facilities for volleyball, foosbal and rollerblading. After their work outs, Googlers can snack in stocked pantry or enjoy an on-sit massage. Young Googlers' preoccu pation with these perks tend to driv mature VCs to distraction. "If I hea one more [punk] complain about hi omelet, or tell me he's bored with th smoothie selection, I'm gonna, don't know," splutters one.

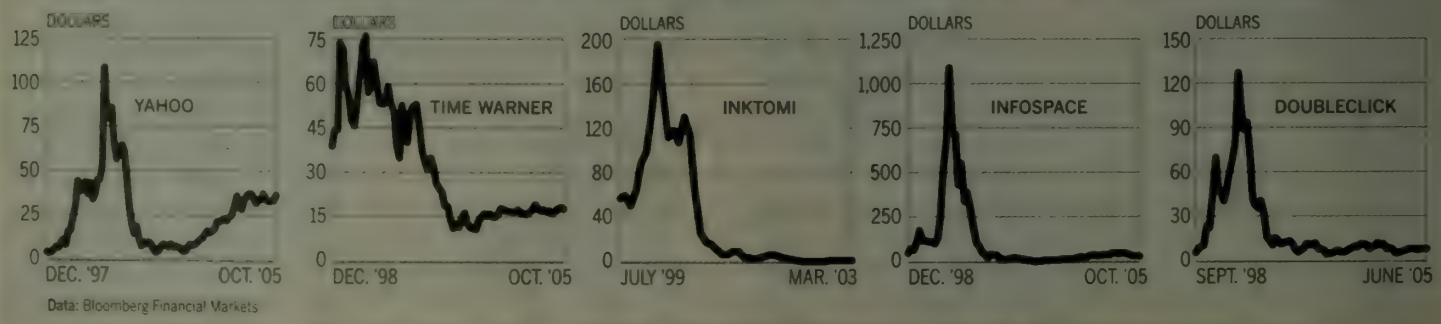
Of course, such luxuries aren' the real problem. It's what the VCs perceive as arrogance and a lack o respect for the role they play. VCs after all, have at some point identified, believed in, nurtured, an funded—not to mention made huge profits from—the biggest names in techdom, from eBay to Cisco Systems and Google itself. Yet many feel that Google accords them roughly the same respect as it does vendors bidding on the groundskeeping contract.

Startup Day

MANY VCS, FOR EXAMPLE are still fuming over the "Google Startup Day." VCs, who are used to making elaborate and proprietary pitches to potential investors, were instead summoned as a group to take turns making their spiels to Google's 10-person corporate development group. "Check out the gall," says one, sharing an Aug. 3 e-mail from Google's in-house M&A team. "Hi Very Senior Partner," the mass memo says by way of salutation. After explaining the hoops through which the VCs

LIKE A SUPERNOVA

The shares of these companies once soared to the heavens. Now they've come down to earth, if they're even still around.



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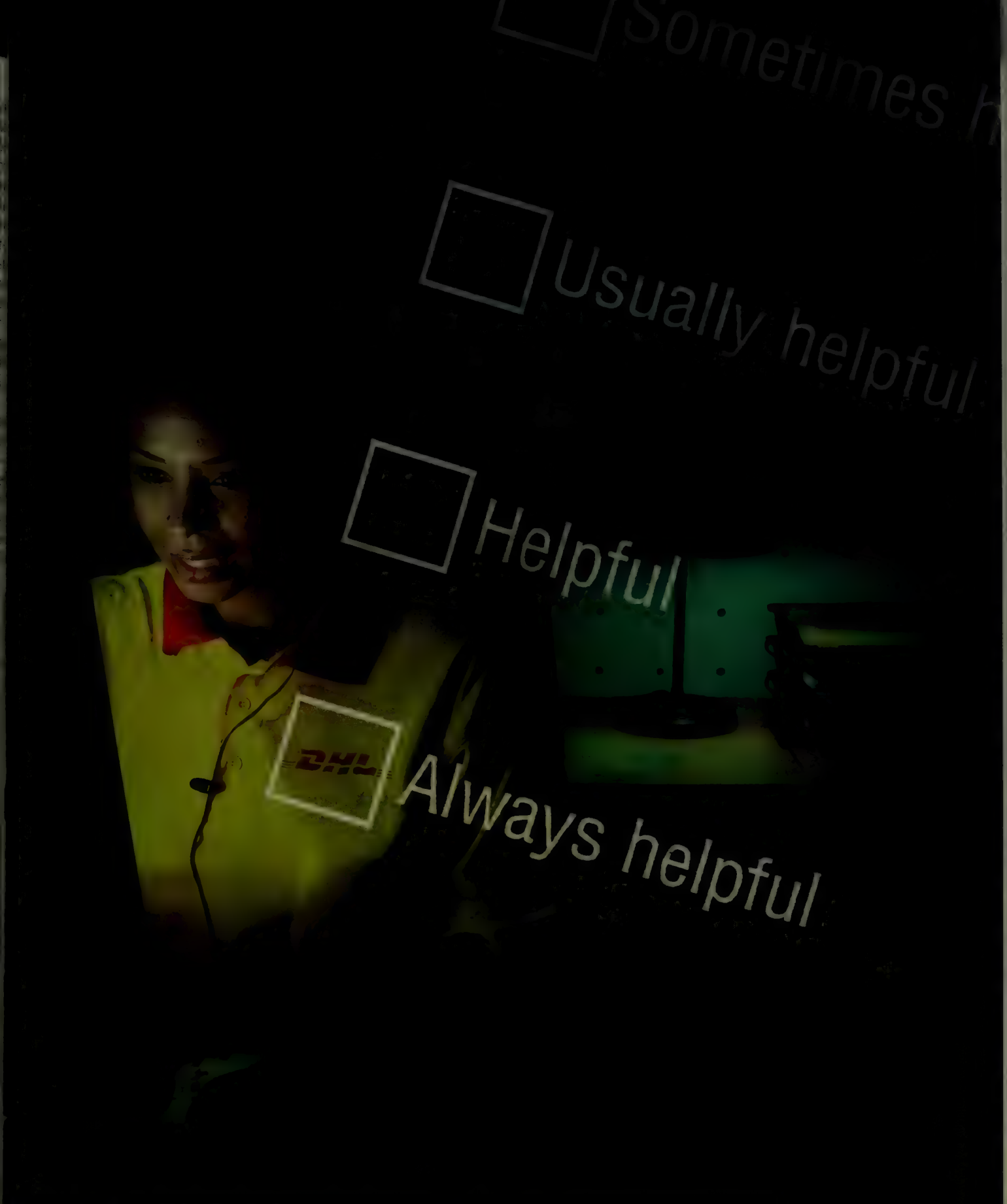

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would have to jump to go to Startup Day, it asks those interested to "please fill in the attached spreadsheet with a brief description of each company and its business/technology, an overview of the team, any data points you would like to share, and a perspective of why the company might work with Google." Says the aggrieved VC: "Did it ever occur to them that this was like asking us to do their homework for them? It's the height of arrogance." Not so, responds Google's Drummond: "This was an attempt at outreach," he says. "Most VCs do like to talk to us. Google is very much involved in the venture community—a lot more than people understand."

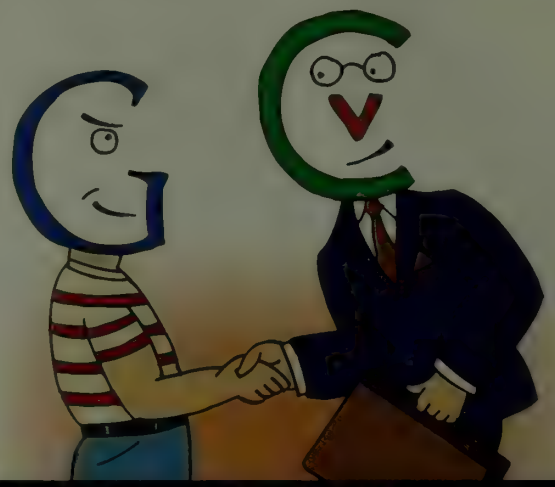
All the same, two Google insiders privately groused to *BusinessWeek* about the stunt. These companies would be foolish to cough up their trade secrets to Google, they contend, while the search giant offers little information in return.

Although Startup Day never happened, Google said it did subsequently meet with individual VCs. As Credit Suisse First Boston's George Boutros, a lead Google banker, says: "If Google wants access to the venture community, Google gets access to the venture community."

Plug N Play Acquisitions

VCs HAVE ANOTHER more concrete reason to resent Google: With its deep pockets and its unwillingness to give quarter to outside professionals, it's now a growing competitor to Valley VCs. Google can easily afford to swoop in and outbid any VC for a startup, particularly if Brin and Page truly mean they would be happy with a 1-in-10 chance of an investment paying off big. That's encouraging entrepreneurs to "bootstrap it"—go it alone, lean, mean, and cheap, without the help of expensive VCs, in the hopes of pocketing a bigger share of the proceeds of a sale to Google. For example, Google bought both Blogger.com parent Pyra Labs and wireless player Android Inc. directly from their founders. According to people familiar with the deal, the Android buyout was essentially a bet on the company's star-studded cast, including engineering whiz Andy Rubin, who previously had founded handset maker Danger Inc. Cofounder Page, the sources say, put the acquisition on the fast track.

Indeed, Google strongly prefers to gobble up startups before they have embarked on a sales and marketing strategy, viewing companies that are completely tech-focused as a better cultural fit. It prefers to acquire small, local technology teams that it can simply plug into its headquarters. "Two guys in a garage with nose rings and a dog trying to catch lightning in a bottle" is how banker Smith characterizes the bias. Case in point: Last year Google snapped up Keyhole, a digital mapping company based next door in Mountain View, for an undisclosed sum. Its team moved down the road and within six months, Keyhole was providing the satellite technology behind Google's celebrated mapping tool.



Venture Capitalists

Venture capitalists are hatching and funding startups designed to appeal to Google. Even if the company doesn't bite, the VCs will have no shortage of suitors from among Google's rivals. But Google's penchant for small buyouts is emboldening entrepreneurs to skip the VCs and proceed directly to Mountain View when they're ready to sell.

Conversely, Google has passed on larger, out-of-town deals, in large part because of integration worries.

Google is creating a whole new ecosystem for entrepreneurs, says Baris Karadogan of U.S. Venture Partners, a high-tech VC firm in Silicon Valley. Karadogan says he's closely watching a group of entrepreneurs who are designing a highly specialized online advertising tool, hoping to sell it to Google for $50 million. "Before," he laments, "you needed a VC. Now you can build a Linux-based data system for $100,000 and survive long enough to sell without ever raising a venture round."

The suits inside Google don't fare much better than the outside pros. Several current and former insiders say there's a caste system, in which business types are second-class citizens to Google's valued code jockeys. They argue that it could prove to be a big challenge in the future as Google seeks to maintain its growth. They deem the corporate development team as underpowered in the company, with engineers and product managers tending to carry more clout than salesmen and dealmakers.

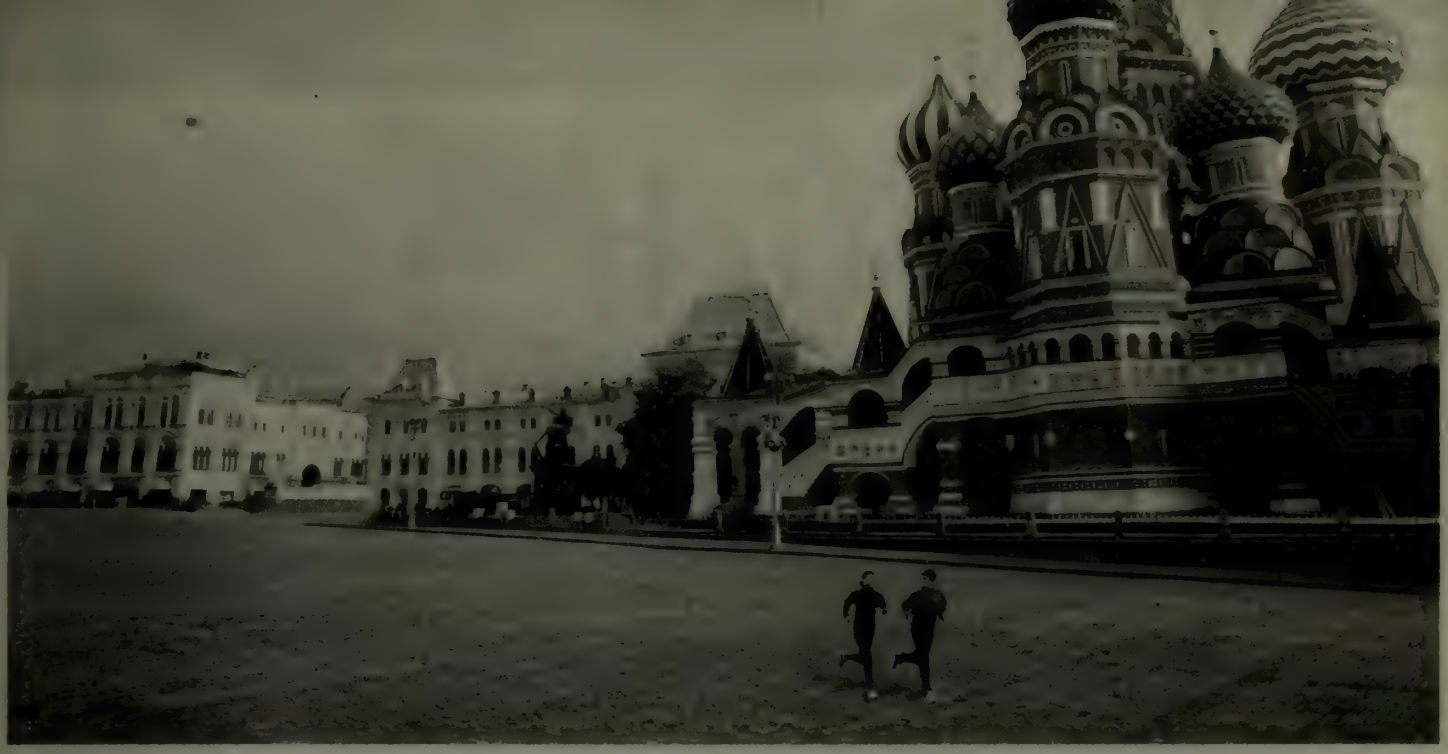
A banker who interviewed for a Google corporate development job came to a similar conclusion. "They just aren't very focused," says the prospective hire, who didn't get the job. "They're biased against businesspeople, and their deal strategy is pretty much, 'O.K., if we see something, then we'll look at it.'" The candidate, a Wall Street tech M&A specialist who was looking for a change of scenery and a more relaxed lifestyle, calls the experience "chaotic, bureaucratic, and very rigid." Strung out over more than nine months and numerous coast-to-coast flights, the courtship culminated in a jarring "pop quiz." The corporate development team suddenly broke from the script and gave the banker a laptop and 40 minutes to value a business, suggest a strategic buyer, and present a case to the entire team.

Drummond rejects the accusations that Google is anti-businesspeople. He says Google has hired many MBAs and bankers and is constantly assessing its dealmaking strategy. "At some point," he adds, "it might make sense for us to be [acquisitive] like a Cisco or GE."

Apparently, that time has not yet come. Surprisingly for a company of Google's size, clout, and business needs, it doesn't yet have a thriving in-house VC arm. And that's despite some glaring holes in its product lineup. "We're clearly not going to do everything right," concedes Drummond. "There are areas we miss that others will fill out." For starters, Google has a long way to go to match the breadth, depth, and richness of Yahoo's portal. Ditto a peer-to-peer marketplace along the lines of an eBay, as well as Microsoft-like software applications.

Despite the hurdles they face, don't expect any of the legions of investment bankers, VCs, or entrepreneurs to fold their tents and go home. The stakes are too big, and everyone wants in. To steal a note from the Google home page: Feeling lucky? ■

–With Catherine Yang in Washington



I checked my e-mail after I finished the conference call. I replied to the office back in the States

AND

we raced, my usual run becoming anything but.

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Filthy Rich, But Froogle

Brilliant, careful, and skeptical, Googlers are the toughest customers in the Valley when it comes to investment services

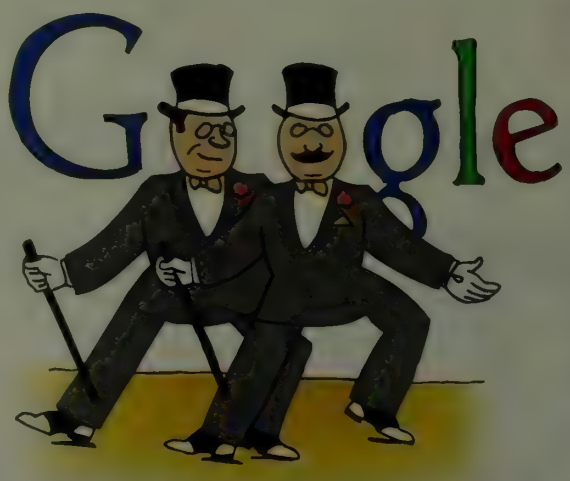
BY ROBEN FARZAD

HIGH-END WEALTH MANAGERS ARE being drawn irresistibly into the Google orbit. It's not hard to see why. Since going public in August, 2004, Google's stock has nearly quintupled from its $85 IPO price, levitating 130% in the past six months alone. That kind of space shot has created some very wealthy people—an estimated 1,000 millionaires and 5 billionaires at the last count—making Google that rare company where one in five staffers is a millionaire, at least on paper.

That makes Google a gold mine for wealth managers, whose eyes well up at the very idea of all the recurring fees that can come from employee assets. Advisers are all over Mountain View, cold-calling Googlers, buttonholing them at geek expos, booking restaurant banquet rooms, and jumping through just about any hoop for a shot at pitching some of the coveted 5,000 employees. (On occasion, the level of some managers' zeal dents their chances. One programmer remembers getting a phone call at 2 a.m. The broker kept dropping names off the employee's online networking profile as though he knew them personally, until the apoplectic Googler realized what was going on and slammed down the phone.)

Google ultimately green-lighted in-house presentations from six firms: UBS, JPMorgan Chase, CSFB, Morgan Stanley, and, notably, independents Presidio Financial Partners and Sanford C. Bernstein & Co. (Google likes to root for underdogs and has a cultural penchant for those without obvious conflicts of interest.) Not that the winners had time to run victory laps once they'd won their privileged access to the Googleplex. Bragging rights aside, they still had their work cut out for them in signing up the rich Googlers.

Some would-be sellers go to extraordinary lengths. Take Carlo Panaccione, a Mountain View area high-net-worth manager a LPL Financial Advisors. First he enrolled his young daughter i a local private school popular among Google families, all th better to meet unwary Googlers. Now he's planning a mommy and-me-type seminar wherein parents can learn financial basic alongside their children. "A lot of them have young kids," h explains. "They do lots of multigenerational planning."



Wealth Managers

Hordes of high-net-worth brokers and money managers are chasing the hundreds of newly minted millionaires—and a handful of billionaires—at Google. They court the young Googlers on the phone, in restaurants, and in conferences. Their goal: Start decades-long relationships that will produce an endless bounty of fees.

Red Herrings

GOOGLE EMPLOYEES, whose ranks include large numbers o brilliant engineers and quants, are tough nuts to crack. Whil they may not necessarily be the most financially savvy, they ar quick studies and obsessive researchers who talk amongst them selves incessantly. That means broker have little chance of winning them ove with prefabricated sales presentations "It's an intellectual sparring session," says Brodie L. Cobb, managing directo of San Francisco-based Presidio. "They do due diligence in spades. They tes every hypothesis and never take anything at face value." Adds LPL's Panaccione: "You're not walking into a room and telling them to jump into this great mutual fund. It's much more complex than that. These are very careful, skeptical people."

Many start by asking bluntly why they shouldn't handle their own wealth-management duties. As Web whizzes, they point out, nothing could be easier for them than running a portfolio with an online brokerage. The brokers' rejoinder: People as rich as they are need someone to give their financial affairs full-time attention owing to taxation, estate planning, and other complexities.

What follows in the interviews is usually a prolonged back-and-forth. It often involves a grilling on financial arcana such as alpha, a measurement of

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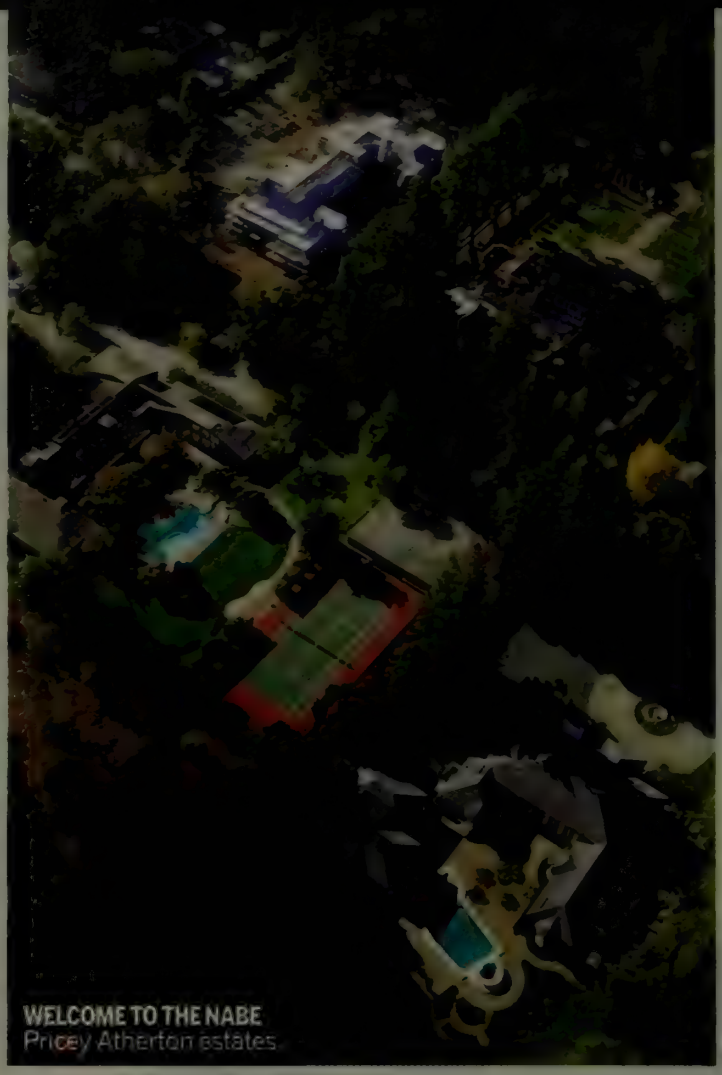
superior investment returns, and asset allocation. To test how advisers think on their feet, Googlers will often throw in red herrings and parenthetical asides about the "random walk" theory of stock pricing. And of course they expect a thorough walk through the mechanics of options collars, which guarantee a future fixed price for their Google stock in return for surrendering the upside. "If you offer a service that has a weakness," says Cobb, "these engineers will find it. They drill down and must understand everything before committing. If you try to gloss over even the smallest thing, they will call you out. These guys get it."

Flash and ostentation cut no ice at Google. Managers hoping to sign up clients need to leave their Aston Martins at home in the garage. The status vehicle of choice at the Googleplex is the Toyota Prius hybrid, which both co-founders Sergey Brin and Larry Page drive. Google even offers employees a $5,000 credit for buying an environmentally friendly hybrid car.



WELCOME TO THE NABE
Pricey Atherton estates

Being up on the ins and outs of big-time philanthropy, on the other hand, does carry weight with Googlers. Social responsibility, both corporate and individual, is a fundamental part of the Silicon Valley culture. Google.org, for example, the company's $1.2 billion philanthropic arm, was conceived to address global poverty and environmental challenges.

For personal giving, Community Foundation Silicon Valley reports that it has helped at least a dozen Google families to set up donor-advised funds since the firm's IPO. "It's a terrific response given how recent the IPO was," says foundation spokeswoman Michelle McGurk.

"Giving Back"

CONSIDER FRANK JERNIGAN, a former senior software engineer who left Google in June after four years at the company. He was attracted by the philanthropic approach. "This was my way of giving back, to help other people with the resources I've been given," he says. Toting his IPO windfall, Jernigan met with three separate wealth managers on Google's campus. Ultimately he signed up with Bernstein, which he says won him over with its independence and the way it pitched him on setting up a foundation. Bernstein will manage his investments, while a philanthropic service, Foundation Source, helps him find recipients in HIV research and homeless causes. "I just get to do the fun part," he says.

Other personal-service vendors are also working frantically to land Google clients by thinking—and marketing—like a Googler. Brande Kramer, the Silicon Valley manager of matchmaker It's Just Lunch, says he's still tryin to set up an on-campus presen tation at the Googleplex. "Yo would be crazy not to make con tacts over there," he says.

If you type the "GOOG" ticke into Google's search line, you' find Silicon Valley homebuilde James Witt's ad for new home in the area on the sponsore links margin. Shrewd real estat players like Witt pay as much a $3 for each click on the two square-inch pieces of pixilate property. With typical five-bed room homes selling for a cool $ million—and estates usually a least twice as much—that's bargain price for such ad space "Rather than buy an expensiv ad aimed at dumb peopl watching the Superbowl, would rather target someon smart enough to get hired a Google," says Witt.

Despite their reputed arrogance, rich Googlers show humility in managing their own finances. Whether it's putting money into charity or taking some of their Google dollars off the table and moving them into other investments, they're not about to fall into the same trap that hurt hundreds of former paper millionaires in Silicon Valley

Panaccione can tick off scores of former clients, employees of such companies as Netscape Communications Corp. and portal-Internet service provider Excite@Home, who saw their once-considerable net worth vanish into thin air in a matter of months. (Once valued at $35 billion, Excite ended up worthless. Its old headquarters, just up the road from Google's, was recently converted into a hospital.)

Converting at least part of their Google stock holdings into other forms of investment seems to make eminent sense for the Googlers. "No matter how incredibly great Google is doing now," says Panaccione, "at some point there will be a Google-killer out there." Adds Geoffrey D. Baldwin, managing director of San Francisco investment bank Perseus Group: "If the world [can] change as rapidly as it has in Google's favor, it could just as rapidly change away from them." This time, the engineers are listening. ■ *–With Jessi Hempel in New York*

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A Digital Dodge City

The high-stakes battle between Verizon and Cablevision over a town on Long Island

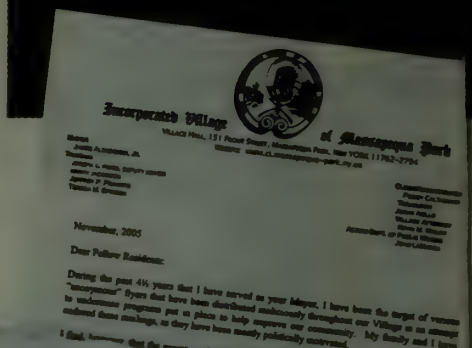
BY SPENCER E. ANTE

JAMES ALTADONNA JR. won a heated election in 2001 to unseat the incumbent mayor in Massapequa Park, a comfy middle-class suburb on the south shore of New York's Long Island, and he has since been reelected twice. But he has never had his reputation attacked as fiercely as this year, when he got caught in the middle of a fight between two of the country's most powerful communications companies.

The clash Altadonna has become embroiled in pits Cablevision Systems Corp., the sole provider of cable TV in Massapequa Park, against Verizon Communications Inc., which wants a license to offer a competing television service. Altadonna, who serves as mayor part-time and donates his $7,000 salary to the village, thinks Verizon should get its license so residents have more choice. Yet after he pushed through that approval, Cablevision on Oct. 17 slapped the village, its trustees, and Verizon with a lawsuit. Then a Cablevision-funded group distributed fliers and advertised in local papers, accusing the mayor of betraying his town.

Altadonna isn't backing down. The 45-year-old, who runs a local printing company and has lived with his wife and three children in Massapequa Park for 12 years, is sending residents a letter criticizing the fliers as "misleading and deceptive." He says Cablevision is simply trying to delay competition. "The scare tactics they use are ridiculous," he says. "You wouldn't think a billion-dollar company would pick on a mayor." Cablevision says it is not trying to prevent competition. Its goal is to stop Verizon from getting a special deal.

This is just one skirmish in perhaps the most contentious battle in the communications industry. A Digital Age equivalent of the Hatfields and the McCoys, Verizon and Cablevision are shooting it out in



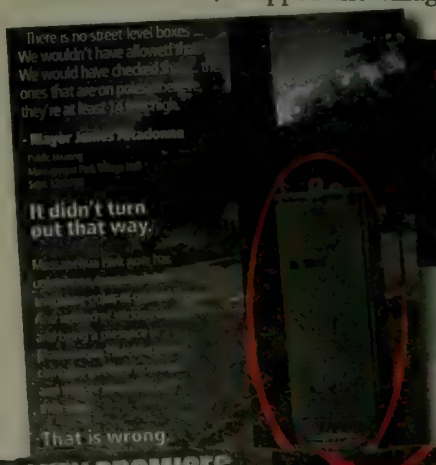
Incorporated Village of Massapequa Park

November, 2005

Dear Fellow Resident:

During the past 4½ years that I have served as your Mayor, I have been the target of various "anonymous" flyers that have been distributed maliciously throughout our Village in an attempt to undermine programs put in place to help improve our community. My family and I have endured these mailings, as they have been mostly politically motivated.

I find, however, that the recent mailing distributed "anonymously" by Cablevision is especially derogatory and hurtful and, as with all these flyers, misleading and deceptive. As I typically don't respond to such tactics, the subject of Competition for our Cable Service is so important that I am compelled to speak out.



BROKEN PROMISES. UGLY PHONE COMPANY BOXES. MASSAPEQUA PARK DESERVES BETTER.

Web Warfare

Cable and phone companies are ferociously competing for each other's customers, but the battle between Verizon and Cablevision may be the most contentious anywhere. One flash point is the village of Massapequa Park

THE STAKES Verizon wants to use its high-speed fiber lines to offer television service to the 17,500 residents of Massapequa Park. The village approved the company's license.

THE LAWSUIT Cablevision filed a lawsuit against Verizon and the village's board, led by Mayor James Altadonna Jr., alleging violation of the state's open meeting law.

THE ATTACKS A Cablevision-funded group sent out flyers criticizing Altadonna for supporting Verizon. Altadonna fired back with a letter he's sending to every resident.

ALTADONNA Cablevision has criticized the mayor in ads

town after town across the New York region. Their battle reflects the changes sweeping the tech landscape, with cable companies trying to grab phone customers and phone companies jumping into the cable-TV business.

Yet the clash also shows the benefits of bare-knuckled competition. As they slug it out, Verizon and Cablevision are steadily coming out with better services and lower prices on everything from traditional telephone calling to speedy Net access. In August, Verizon introduced a low-end broadband service for $15 a month, half the price of its previous entry-level offering. In November, Cablevision unveiled broadband with speeds of as much as 50 megabits per second, trumping Verizon's 30 megabits. "Consumers end up getting more products with better prices and greater value," says analyst Anthony Noto of Goldman, Sachs & Co.

Their fight offers a study in contrasts. Cablevision is a combative, entrepreneurial outfit run by the eccentric father-and-son team Charles and James L. Dolan. James now runs the Bethpage (N.Y.) company, which also owns Madison Square Garden and the New York Knicks. Verizon is the quintessential corporate icon, a descendant of Ma Bell. Based in Manhattan, Verizon is headed by Ivan G. Seidenberg, a diplomatic exec who shuns the spotlight.

The wrangling dates back to late 2003, when Dolan's Cablevision became the first cable company to offer phone service over its fiber lines. With its stronghold in the New York region, Cablevision added phone customers quickly and now has more than 600,000. About 13% of the people who can get its phone service have signed up, giving Cablevision the highest success rate of any major cable company. Cablevision has also aggressively offered broadband service, and now claims 1.6 million subscribers. "They are going to fight Verizon every step of the way," says analyst Craig E. Moffett of Sanford C. Bernstein & Co.

THE SANDWICH INCIDENT

SEIDENBERG'S RESPONSE to such challenges has been a counterattack of head-spinning risk. Alone among the phone companies, he's spending billions to string fiber-optic lines into peoples' homes, so Verizon can offer them cable TV and blazing Net service that could one day reach 100 megabits. Verizon offers the Net service, dubbed FiOS, in hundreds of towns nationwide, but its TV service is being rolled out more slowly. Verizon needs to win government approval to offer TV, in most cases from each town or village.

As Massapequa Park demonstrates, the battles for those approvals can be bruising. Verizon began serious negotiations with the village over the summer and participated in a Sept. 12 public hearing on the issue. About the same time, Cablevision's director of franchise management, Jeffrey M. Clark, called the mayor and said the company was planning to run ads condemning the Verizon franchise in local papers. According to an affidavit from Altadonna, Clark offered to pull the ads if trustees postponed a vote on the agreement scheduled for later that month. Altadonna refused. Through a Cablevision spokesman, Clark denies the allegation.

The day trustees planned to vote on the new franchise, Sept. 26, they held another public meeting that hundreds of locals attended. During the hearing, Altadonna and the others took a 15-minute break to eat in a private room before they returned and approved Verizon's application. That 15-minute break is at the heart of Cablevision's lawsuit. The company alleges trustees violated the state's open meeting law by discussing the franchise behind closed doors. Altadonna says they simply ate sandwiches. "There's no question the village followed the law," he says.

Even after the vote, Cablevision has tried to persuade Massapequa Park residents to oppose Verizon. A few weeks later, a trade group, financed by Cablevision, sent flyers out accusing Altadonna of reneging on a promise to keep Verizon's cable equipment above street level. Still, most town residents seem to be on the mayor's side. "I wouldn't mind having some more competition," says Maria Walsh, a 42-year-old local.

Besides the lawsuit and the public relations campaign, Cablevision is appealing to New York regulators. (In New York, the state must confirm the franchises approved by local governments.) The cable company alleges Verizon got a sweetheart deal, with terms that are better than Cablevision's own. Among other things, Cablevision contends that Verizon isn't obligated to offer television service to every resident. "[The agreement] has loopholes that allow it to pick and choose neighborhoods," says a Cablevision spokesman. Altadonna and Verizon say that's not true.

The cable company is pushing hard to win over state regulators. It's sending letters to local mayors, urging them to lobby regulators to reject Verizon's Massapequa Park franchise, according to documents reviewed by *BusinessWeek*. Cablevision's argument is that Massapequa Park could serve as a template for new cable franchises in other towns—and that it's one that will poorly serve local communities.

Massapequa Park's fate should be decided soon. State regulators are expected to rule on Verizon's franchise in the coming weeks. And the state Supreme Court is expected to issue a decision in the Cablevision lawsuit next month. If state regulators approve the deal, Verizon plans to start offering cable TV, even if the suit is still in litigation.

Meanwhile, Altadonna is busy addressing one of the issues Cablevision has raised. On a recent sunny morning, he pulls up to the street where two Verizon cable boxes are located. The company's technicians are installing similar boxes 15 feet in the air and removing those near the ground. Rolling down his car window, Altadonna says, "I'm the mayor."

"This box is going to be taken away," says Brad Helford, a technician. "That's what you wanted, right?" Altadonna smiles. "Yup. I always live by what I say."

After he drives back to his office in Town Hall, Altadonna puts the finishing touches on his letter to village residents. "My integrity is not negotiable," it reads. "No malicious fliers, mailed by cowardly, spiteful individuals, will deter me from doing the right thing." ■

Computer, Heal Thyself

Intelligent machines that can learn and fix themselves are becoming a reality

RICHARD BORGE

BY STEVE HAMM

BACK IN THE FALL OF 2001, Paul Horn was wrestling with the computer industry's demons. The former University of Chicago physics professor had been running IBM's research labs since 1996. During that time, the Internet, wireless technologies, and open-source software had exploded in popularity. But the complexity of all the new technologies threatened to overwhelm customers, both corporate and individual. He sat down to bang out what he terms "a call to action," a paper entitled the "Autonomic Computing Manifesto." "Things were getting crazy," he says, "and the only way to fix it was to have the entire community working together on the problem."

His idea was simple. Scientists needed to come up with a new generation of computers, networks, and storage devices that would look after themselves. The name for his manifesto came from a medical term, the autonomic nervous system. The ANS automatically fine-tunes how various organs of the body function, making your heart beat faster, for instance, when you're exercising or stressed. In the tech realm, the concept was that computers should monitor themselves, diagnose problems, ward off viruses, even heal themselves. Computers needed to be smarter. But this wasn't about machines thinking like people. It was about machines thinking for themselves.

DIGITAL DETECTIVES

NOW THE RESULTS of Horn's epiphany are beginning to arrive in force. IBM just released a trio of software products that monitor computing systems, restart them automatically after a power outage, and shift processing jobs around bottlenecks the way cops detour cars around accidents on the highway. Cisco Systems Inc. has lined up a series of so-called application-oriented networking products capable of peeking inside the packets of data that move across the networks and making decisions about how to best route them. And next year Microsoft Corp. plans on delivering smart technologies in the new version of its Windows operating system—one that will sense when a disk drive is about to fail and warn people so that they can save vital documents and photos.

Tech companies that can deliver such sophisticated technologies will get a jump on their rivals. In the $800 billion corporate computing market, prices are steadily dropping for run-of-the-mill PCs, computer servers, and networking gear. But products that make computing cheaper or easier still command a premium. That's why there's so much pressure on tech companies to make machines that can think for themselves. "It's one of the only ways they still have to differentiate themselves from the competition," says

Get Smart

Computer scientists are working hard to create computers and networks that can think for themselves. Here are some of the machines' attributes:

Ultimately, the machines can make computing easier—and cheaper

ıalyst Joe Clabby of market researcher ımmit Strategies Inc.

Initially, only a handful of these smart chnologies will be visible to regular nsumers. In addition to the Windows ɔuble-spotting software, several comınies have come out with technologies at allow employees to plug laptops into mpany networks without fear that ey'll infect the network with viruses. ıe products halt the PCs from initially ıining access, search them, and kill off ruses or patch them with software that ıts them in compliance with company curity policies. It's the digital equivant of being strip-searched by police at the airport.

Most of the early smart technologies are geared to help corporations manage their sprawling networks and data centers. That's where computing has become such a tangle that the average company spends $9 on managing technology for every $1 it spends on creating applications. It also leaves them vulnerable to hacker attacks and makes it difficult for the tech industry to deliver on one of its promises of the 1990s: to make computing as simple to tap into as the electrical grid. "This is very important," says Nicholas G. Carr, author of the book *Does IT Matter?* "Automation addresses the complexity problem, which is the biggest problem in computing."

A few nervy corporations have volunteered to be guinea pigs. "It's early days, but I want to advance the cause of autonomic computing," explains Dennis Callahan, chief information officer of Guardian Life Insurance Co. in New York City. His company uses software from IBM to spot problems in a computing system that helps insurance agents put together sales proposals for clients. It has pared the time required to fix things by 90%.

IBM has made autonomics one of the centerpieces of its technology vision. Horn has assigned more than 100 research scientists to the project, and the company has woven more than 475 autonomic features into 75 software and hardware products. A cool one: a technology called eFuse that senses problems in a computer chip and automatically cuts off problem transistors so that the device can deliver reliable number crunching.

Some of the industry's smart products are essentially digital detectives. Data-storage leader EMC Corp.'s Smarts software creates diagrams of complex networks and, when a glitch occurs, sorts through dozens of symptoms to discover the cause. A few months ago a huge European telecom network run by COLT Telecom Group PLC began to behave sluggishly. Within minutes, Smarts discovered that the problem originated in a single data-routing machine in Madrid. Not only that, but it figured out that the router had simply overheated during a sweltering summer day. Smarts sent out an alert, and a technician moved the machine a few inches to improve air flow. Problem solved.

VIRUS THROTTLE

THE NEXT STEP IS to create machines that heal themselves as well as diagnose problems. Think of them as digital doctors. So far, only a few self-healing technologies have made it out of the labs. One, Hewlett-Packard Co.'s "virus throttle" technology, spots evidence of suspicious virus activity in a network, gradually squeezes off connections to the affected machines as it investigates. If real trouble is found, cuts off those machines from the rest before major harm can be done.

Techies are wrestling with how much intelligence they can inject into computers. Ozalp Babaolu, a computer scientist and professor at the University of Bologna in Italy, for instance, believes that it will be too difficult to design self-healing capabilities into large networks of computers. Instead, he believes, machines need to be designed so they are capable of learning through interactions with each other and adapting just as living organisms do. "We have to do some of the things in computing that biology does," says Danny Hillis, a computer scientist and principal at tech consultancy Applied Minds Inc.

That vision for computing is still a long way off. Horn's quest, despite the recent product introductions, isn't over. He warned in his manifesto that much work has to be done, and quickly, to shore up information technology "before it collapses on itself in a jumble of wires, buttons, and knobs." While IBM, Microsoft, and others have made progress, the industry has to make a lot more before it can heal itself. "I thought this would be hard, but it turned out to be even harder than I expected," says Horn. ■

F-MANAGING

ɔuters and networks ɔr their own activities act when something vorking optimally. In centers, when one uter is overloaded, t software can detect it utomatically reroute jobs ɔther.

SELF-DIAGNOSING

Software sensors detect problems and then use complex math algorithms to do so-called root cause analysis to sort through an array of symptoms and figure out what's wrong. The software then alerts operators and tells them how to fix the problem.

SELF-REPAIRING

In some cases, smart technology can not only figure out what's wrong but also fix the glitch itself. IBM, for instance, has technology that shuts down part of a computer chip if it's not working properly, allowing the device to keep doing its job.

Gene Therapy Is Respectable Again

Researchers have learned caution, and some of the early results are promising

BY ARLENE WEINTRAUB

WHEN MATTHEW During and Michael Kaplitt first went hunting for capital to commercialize their research in gene therapy, their timing couldn't have been worse. It was the fall of 1999, just after teenager Jesse Gelsinger died in a clinical trial of gene therapy—the use of genes to deliver medicines to diseased cells. Together, During and Kaplitt were able to scrape up an initial $2.5 million. "Maybe we were arrogant to think we could start something at that time," Kaplitt concedes. Today, the two physician founders of Neurologix Inc., in Fort Lee, N.J., are feeling much more upbeat. They're searching for $10 million to fund a pivotal trial in Parkinson's disease, and they expect to find it.

Others are also prospecting in the once-neglected field of gene therapy. On Nov. 7, Colgate-Palmolive Inc. invested $20 million in Austin-based Introgen Therapeutics Inc., which is pursuing novel remedies for oral cancer. And the Michael J. Fox Foundation is about to award its first ever grant for gene therapy research. The $750,000 will go to San Diego-based Ceregene Inc., which, like Neurologix, is zeroing in on a treatment for Parkinson's, the disease that afflicts actor Fox. Ceregene also raised $32 million in vent capital last year.

UNBOWED During and Kaplitt have a better shot at funding a Parkinson's trial now

Recent success stories in clinics a labs add to the sense that gene therap moving back into the mainstream. Chi has been quietly approving such tre ments. And on Nov. 22, Genzyme Co in Cambridge, Mass., announced it w spend $3.2 million to acquire a man facturing facility that will make seve gene therapy treatments, including o aimed at a common condition amo the elderly called peripheral arterial d ease. "We've been in gene therapy a lo time, and we've seen the ups a downs," says Richard Gregory, Ge zyme's senior vice-president of researc "But we're optimistic."

Champions of ge therapy today say th they have learned fro the mistakes of the pa The original dream w to repair faulty DNA b replacing the genes th malfunction and cau disease. Researchers a tach copies of healt genes to viruses—know as vectors—which th ferry the genes into cel But Gelsinger had a ra metabolic disorder th may have caused an in mune reaction to t virus used in the tri Gelsinger's death was a tributed to that reactio not the gene.

Gene therapy comp nies say they have figure out how to sidestep t virus-overload risk. N only are they vigila about making sure the technology is onl applied to patients who are fit enough t weather potential side effects, but they' getting better at containing the vir transporters. In Parkinson' for example, both Ceregen and Neurologix are deliverin genes only to the diseased pa of the brain. The implante genes make their way int brain cells, where they chur out substances that have bee depleted over the course of th illness. In tests, there is no indi cation that the viruses do harm in the brain or are capable o moving throughout the body What's more, explains Cere gene CEO Jeffrey Ostrove "We're delivering extremel

Gene Therapy Reborn

After well-publicized setbacks in early gene therapy experiments, investors bolted. Now they're giving the field a second chance. Here are some startups that have succeeded in raising funds:

COMPANY	BIG BOOST
INTROGEN THERAPEUTICS	On Nov. 7, Colgate-Palmolive invested $20 million in this company, which is developing gene therapy treatments for oral cancer, some delivered in mouthwash-like rinses
NEUROLOGIX	Its treatment for Parkinson's disease attracted $5 million from private investors in 2005, and positive trial results in September pushed its lightly traded stock up 10%
CEREGENE	It struggled to raise $32 million in venture capital in 2004, but recent progress with its treatments for brain diseases has some VCs asking to join an upcoming funding round

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mall volumes—like a drop from an yedropper."

Other biotechs are finding innova- ve ways of delivering genes exactly here they're needed. Introgen in- ented a mouthwash that contains, mong other things, a benign form of e common cold virus. Introgen uses to carry genes known as tumor sup- ressors, which rid the body of cancer- us cells. This form of the therapy pecifically targets precancerous rowths in the mouth. CEO David ance believes Colgate's recent invest- nent in Introgen—the consumer- roducts giant now owns a 9.7% take—will spur other investors to give ene therapy a second peek: "It opens e door and validates the idea of using ese therapies in new ways."

ICTORIOUS VECTORS

F COURSE, PUTTING a gene in place sn't the end of the story. You might also eed to switch that gene on and off. hat mechanism is the focus of tiny heoGene Inc., a startup owned by the niversity of Pittsburgh Medical Center. iotechs are also seeking out safer ransporters. One popular vehicle is the ommon adeno-associated virus (AAV), hich doesn't cause illness in humans. We hope it becomes the safe vector," ays David Lowe, a partner with Skyline entures, a Palo Alto (Calif.) venture- apital firm. Skyline is one of four VC irms that invested $15.2 million in ene-therapy startup Applied Genetic echnologies Corp., which, like many thers, uses AAV as a vector. The com- any has struggled to raise funds, but owe believes that things will get easier s other investors regain their confi- lence. "If one company gets it to work, hey'll have washed out years of con- ern," he says.

Some of the country's largest institu- ional investors are starting to pay at- ention. Jordan Schreiber, who manages he Merrill Lynch Health Care Fund, ays he has met with Neurologix and ther gene therapy companies. He's not eady to jump in yet but is watching arefully for signs that one of the many reatments in the pipeline is ready for ate-stage human trials. "I think it's oming, and I'd like to be early," he says.

Overall, Schreiber adds, interest in ene therapy has moved from "a little bove zero to something more heated." or the dogged biotechs that work in his controversial field, the support of ig-time investors will be a most wel- come therapy. ■

A Second Bullet for Cholesterol

Drugmakers are seeking a way to raise the "good," not just lower the "bad"

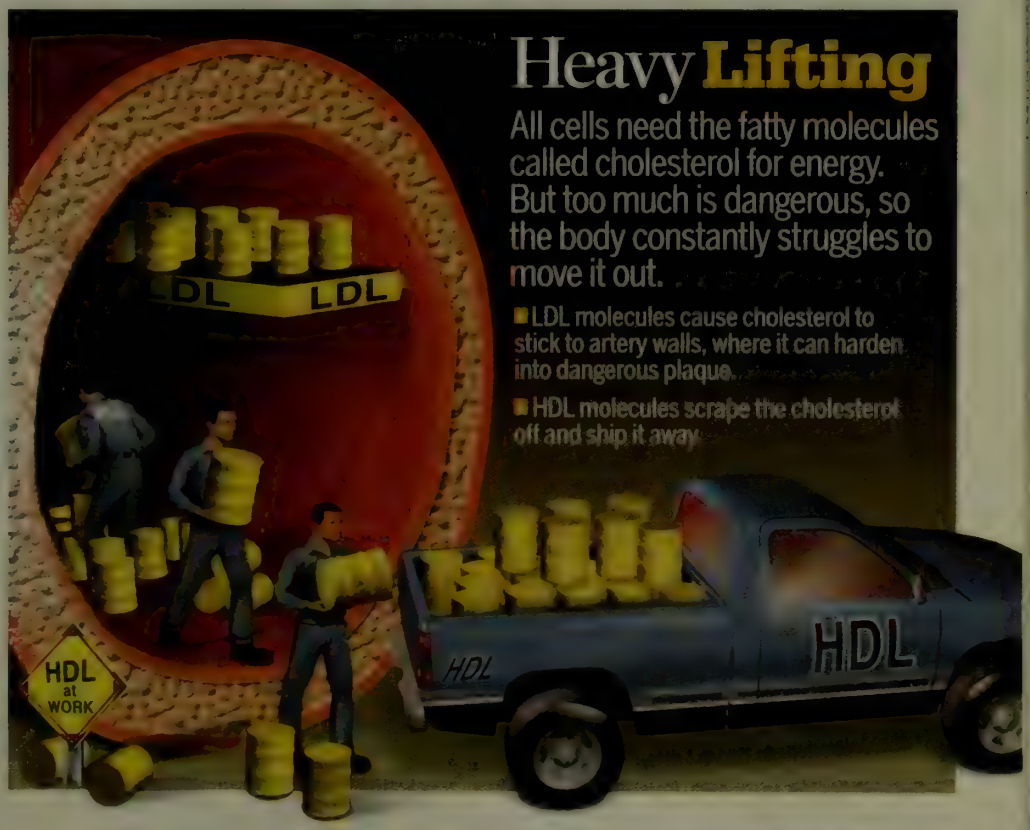
BY CATHERINE ARNST

THERE IS NOTHING THE pharmaceutical industry likes better than a pill that can reduce the risk of disease for millions of people if taken every day. In other words, drugmakers love statins. These cholesterol-lowering medicines, first introduced a decade ago, can cut the risk of heart attack and stroke by a third when taken regularly. As a result, they have become the best-selling drugs in the world, earning billions upon billions for their makers.

But evidence is mounting that lowering bad cholesterol, otherwise known as low-density lipoprotein (LDL) cholesterol, can improve heart health only so much. A just-released study found that upping statin dosages to bring LDL down to extremely low levels offers symptomatic improvement but does not reduce the overall chances of dying from a heart attack.

NO CANNIBALIZING

SOMETHING ELSE is needed, and drugmakers are betting that the next new thing could be a drug that raises high-density lipoprotein (HDL) cholesterol, i.e., the "good" cholesterol. Best of all for the drugmakers: HDL drugs would probably be taken in addition to a statin, so they wouldn't cannibalize the industry's cash cows. Pfizer Inc. is confident



Heavy Lifting

All cells need the fatty molecules called cholesterol for energy. But too much is dangerous, so the body constantly struggles to move it out.

- LDL molecules cause cholesterol to stick to artery walls, where it can harden into dangerous plaque.
- HDL molecules scrape the cholesterol off and ship it away.

enough of this two-pronged approach that it is pouring $800 million into the development of a pill that combines an experimental HDL-raising compound with its top-selling statin, Lipitor.

If raising HDL turns out to be as effective as hoped, medicine cabinets all over the world could end up containing a new class of blockbuster drugs. "What LDL was in the 1990s, HDL will be in the new millennium," predicts Dr. Steven E. Nissen, director of the Cleveland Clinic Foundation.

That doesn't mean heart experts have lost their faith in statins. If anything, they say, far more people should be taking these pills, and lowering LDL levels remains an important goal. But statins alone will not end heart disease's reign as the biggest killer in the industrialized world, and drugmakers continue to look for ways to adjust cholesterol levels.

They Want To Take It Higher

Some drugs that raise HDL molecules

DRUG	HOW IT WORKS
NIASPAN KOS PHARMACEUTICALS	This is a strong form of niacin, a compound in the vitamin B family that plays a role in metabolizing cholesterol. Already available.
ACOMPLIA SANOFI-AVENTIS	Developed as a weight-loss drug, it blocks pleasure receptors in the brain and raises HDL in obese patients. FDA approval is expected in early 2006.
TORCETRAPIB PFIZER	Blocks a protein that transfers cholesterol from HDL to LDL. Pfizer is bundling it with Lipitor, which lowers LDL, into one pill. In late-stage trials.
VACCINE AVANT	Blocks the same protein as torcetrapib. Midstage trials have been completed.

FATTY FUEL

CHOLESTEROL IS NOTHING more than little fat molecules used by all cells as fuel, and labeling them as good or bad is a bit unfair. It is LDL and HDL—the transporter proteins that carry cholesterol through the blood vessels—that wear the white or black hats. When cholesterol is attached to LDL (the bad guy), it sticks to vessel walls, where it can harden and turn into dangerous plaque. HDL plays the hero, scouring the artery walls and transporting excess cholesterol away.

Cardiologists are quick to note that there is already a drug on the market, Niaspan, that raises HDL. Kos Pharmaceuticals Inc. in Cranbury, N.J., has been selling this extended-release form of niacin since 1997, and the company says it currently accounts for about 8% of all prescriptions written by cardiologists. Evidence of Niaspan's effectiveness continues to mount: In a study released in November, Niaspan cleared the buildup of plaque in the arteries of heart-disease patients who had been taking the drug for a year. "That's a very powerful result," says study leader Dr. Allen J. Taylor, director of cardiovascular research at Walter Reed Army Medical Center. "There have been very few interventions that actually reverse plaque buildup."

But Niaspan is far from the blockbuster the drug industry is seeking. Pfizer sold $11 billion worth of Lipitor last year. Niaspan, at a fraction of the price, brought in about $400 million. That's in part because some patients have a hard time tolerating the drug, which causes the face to flush. Coming up with an alternative HDL therapy has not been easy, however. Statins need only to block an enzyme responsible for cholesterol production, giving HDL a fighting chance to keep up with the excess. Boosting HDL productivity is much trickier.

Heart experts have not lost their faith in statins

The most advanced research focuses on a molecule that ferries cholesterol from the good HDL to the bad LDL, called cholesteryl ester transfer protein (CETP). Pfizer's HD candidate, which carries the tongue-twisting name torcetrapib, blocks CETP. Pfizer recently reported that its combination torcetrapib-Lipitor pill raised HDL by 44% to 66% in clinical trials involving 500 patients. But the drug also increased blood pressure, a potential problem for a heart drug. To ensure that the drug is both safe and effective, Pfizer says it will test it on a total of 25,000 people, and an approval likely won't be sought before 2007.

Pfizer has already alienated some cardiologists, however, by deciding to bundle torcetrapib with Lipitor. "A lot of people are looking at their decision not to market this as an independent agent as a way of extending their patent on Lipitor," which expires in 2011, complains Dr. Ira S. Nash, associate director of the cardiovascular institute at Mount Sinai Hospital in New Yor

Long before that expir tion date, other drugma ers will be pushing med cines that have at lea some impact on HD though that may not be primary target. Sano Aventis, for example, h started promoting the HD benefits of its weight-lo drug, Acomplia, widely e pected to win marketin approval early next yea Acomplia blocks cannab noid receptors in the brai and fat cells that contr appetite, among othe things. In clinical trials, helped obese patient achieve modest weight los and raised HDL by an average of 20%.

The trial patients who benefited fron improved HDL lost 15 pounds on averag and reduced their waistlines by 2.7 inch es. This loss of abdominal fat, which i loaded with cholesterol, is the likely rea son HDL rose, says Jean-Pierre Després o the Quebec Heart Institute a Laval Hospital research cente in Ste.-Foy, Que. "There is over whelming evidence that ab dominal fat in particular is high risk factor with heart dis ease," he says.

Of course, abdominal fat, an LDL and HDL cholesterol ca best be controlled with exercis and diet. But patients rarel comply with lifestyle prescrip tives. They don't even comply with their drug prescriptions. As with any chronic disease, studies have found that 50% or more of patients either stop taking statins or don't take them as prescribed, making it difficult to control any kind of cholesterol.

To get around the compliance problem, Avant Immunotherapeutics Inc., in Needham, Mass., has developed an HDL-boosting vaccine. It sets off an immune reaction to a specific region of CETP, the same protein targeted by Pfizer's drug, but it would be taken only twice a year.

Avant completed safety trials of the vaccine a year ago but does not have the resources to conduct the huge clinical trials needed to win approval. The company says it is talking to Big Pharma companies that would be willing to shoulder the costs, however. With statins as the template, shelling out $800 million to develop an HDL drug may turn out to be a bargain. ■

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When the Bill Comes Due

MasterCard's new IPO investors will have to pay the company's legal fees

BY MARA DER HOVANESIAN

PRICELESS. THAT'S THE theme of MasterCard Inc.'s long-running advertising campaign claiming that there are some things in life on which you just can't place a value. Little did the Purchase (N.Y.) credit-card outfit know that someday its own ad shtick could be applied to its upcoming initial public offering. Just what will investors be buying if they invest in shares of MasterCard when it goes public next year? Right now, no one can say for sure.

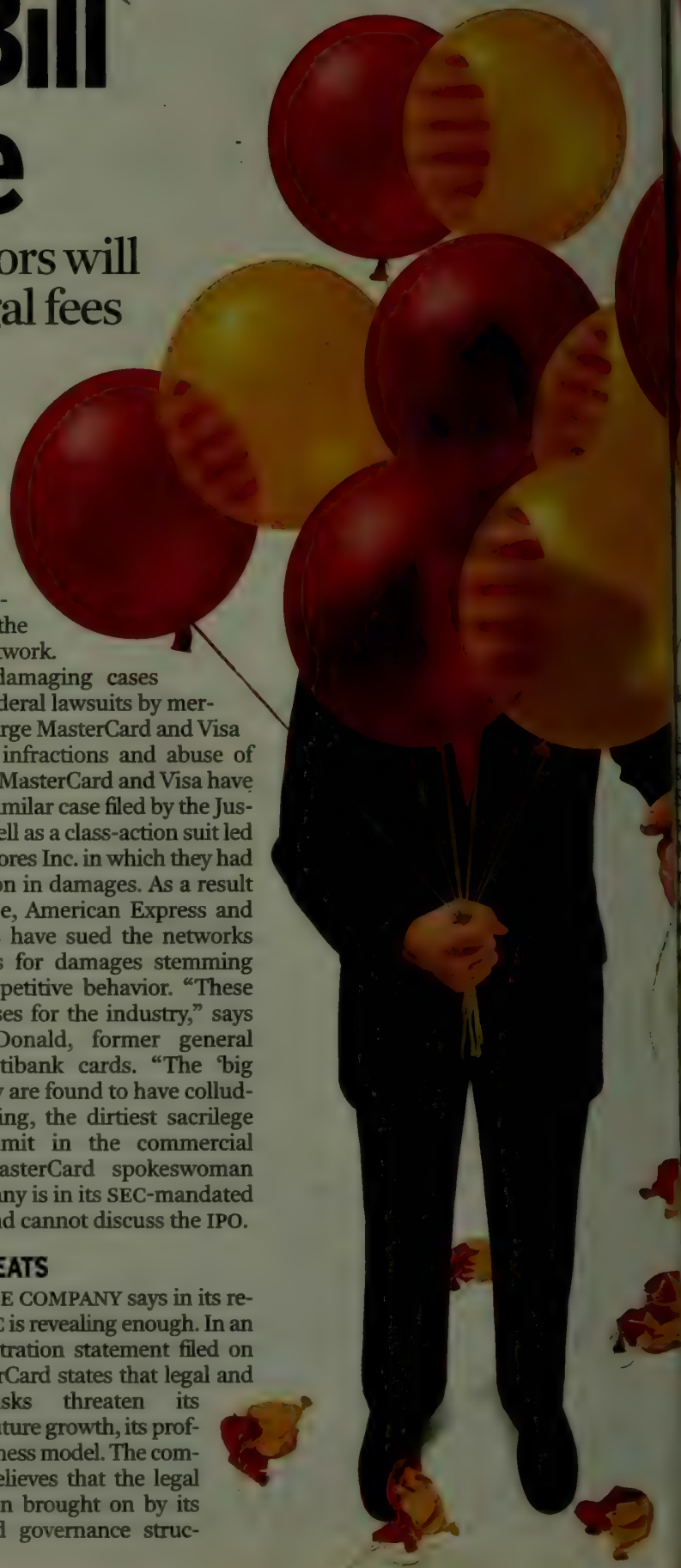
What we do know is this: In the first quarter of 2006, MasterCard—which helped to pioneer the credit card nearly 40 years ago—will convert from a private, members-only club for banks to a public enterprise. Wall Street forecasts a blockbuster IPO that will eclipse the $1.2 billion raised by search engine Google Inc. (page 66). Street estimates put the value of MasterCard anywhere from a conservative $2.65 billion to as much as $7 billion. In a world where plastic has trumped cash as king, MasterCard, second only to Visa USA Inc. as a payment network, seems like a good bet.

But is it? The credit-card issuer is embroiled in dozens of lawsuits that could cost millions in legal fees and tens of billions in damages—and new investors could be stuck with the tab. MasterCard is in a bitter battle with consumers, regulators, and merchants worldwide over issues ranging from data security breaches to processing fees. In filings with the Securities & Exchange Commission, MasterCard says it plans to spend $650 million of the IPO proceeds on legal fees. It has no other reserves to fight this litigation, and although the banks will probably be on the hook for some of it, they're distancing themselves from the MasterCard network.

The most damaging cases are some 38 federal lawsuits by merchants that charge MasterCard and Visa with antitrust infractions and abuse of market power. MasterCard and Visa have already lost a similar case filed by the Justice Dept., as well as a class-action suit led by Wal-Mart Stores Inc. in which they had to pay $3 billion in damages. As a result of the DOJ case, American Express and Discover cards have sued the networks and big banks for damages stemming from anti-competitive behavior. "These are terrible cases for the industry," says Duncan MacDonald, former general counsel of Citibank cards. "The 'big bomb' is if they are found to have colluded in price-fixing, the dirtiest sacrilege you can commit in the commercial world." A MasterCard spokeswoman says the company is in its SEC-mandated quiet period and cannot discuss the IPO.

POTENT THREATS

BUT WHAT THE COMPANY says in its reports to the SEC is revealing enough. In an amended registration statement filed on Nov. 14, MasterCard states that legal and regulatory risks threaten its prospects for future growth, its profits, and its business model. The company says it believes that the legal woes have been brought on by its ownership and governance struc-



ture, and it hopes that by overhauling the board, bringing in new independent directors, and cashing out the member banks who currently set prices, MasterCard can put its egal troubles behind it.

Others aren't so sure. "The liability to he banks and MasterCard is unlimited," ays William McCracken, chief executive of ynergistics Research Corp., a financial-ervices market research outift in Atlanta. Meanwhile, few analysts think that $650 nillion is enough to cover legal bills and amages, and MasterCard says "it is unble to estimate the amount of potential harges." Says Craig J. Maurer, a managng director with Fulcrum Global Partners LC.: "If the motivation to go public is to rotect itself from legal problems, that's a retty thin investing prospect."

There are plenty of good reasons, hough, for MasterCard to do an IPO. It vill gain cash to make acquisitions, invest n new technologies, and hire top talent at time when the payments industry is becoming brutally competitive. New entrants such as Wal-Mart, PayPal, Google, nd even mobile-phone operators are entering the fray. For example, Japan's NTT DoCoMo Inc. plans to aunch new cell phones next year that can function like credit cards, in partnership with Sumitomo Mitsui Financial Group, the world's argest bank. MasterCard also plans to use fresh capital to become a better marketing machine, à la rival American Express Co., as well as to narrow the longstanding gap between its arch-nemesis, Visa USA. MasterCard processed $1.03 trillion in transactions last year, less than half of Visa's $2.27 trillion. AmEx is a distant third, at $414 billion.

Visa, too, is feeling heat from the lawsuits. On Oct. 20 its board approved a plan to change the company's governance structure by replacing bank executives with eight independent directors. Visa, however, will continue to be owned and controlled by its member banks. Elizabeth Buse, Visa USA executive vice-president in charge of product development, says the company has no plans to go public, and she is unsure whether MasterCard's reorganization "will afford it any more legal protections than Visa's ownership and governance structures will afford Visa."

Both card networks will soon find out. They and their partner banks face their nastiest legal tussle over so-called interchange fees. These are the lucrative charges that banks and the networks collect from merchants every time a credit or debit card is used to pay for a purchase. Merchants typically pass these charges, which by some estimates add up to more than $24 billion each year, on to consumers in the form of higher prices.

"A CIVIL WAR"

VISA AND MASTERCARD have argued for years that their fees are fair. U.S. regulators have yet to weigh in. But foreign governments have so far sided with the merchants. The Reserve Bank of Australia mandated lower fees in 2001 and the European Council and Britain's Office of Fair Trading are considering regulation. Because of class-action laws that are unique to the U.S., legal and credit-card experts here anticipate an ugly battle between lawyers representing the merchants and the banks. "It's a civil war," says MacDonald, who argues that the government should step in.

The big banks are beginning to issue rival cards

Even MasterCard's best customers are making things tough. As banks and merchants each consolidate, they are negotiating lower processing rates, thereby squeezing its margins. And as they shed their member status, big banks such as Citi and JPMorgan Chase will finally be free to promote their own brands over the network. This is no small issue. A huge portion of MasterCard's revenue is concentrated among its five largest customers. For the first six months of 2005, these customers represented $485 million, or 34% of revenues. The loss of any one customer could hurt the business. Already, Citi and GE Consumer Finance have announced they will issue rival American Express and Discover cards.

The timing of the IPO seems to be working against MasterCard, too. Financial companies have made up almost a fifth of IPOs in the last few years as newcomers have benefited from low interest rates. Returns for 2005 listings have been decent, up 7% vs. the S&P's 3.5% gains. But consumer credit quality is faltering and personal bankruptcies are up. The value of MasterCard going public? Hard to say. ■

–With Justin Hibbard in San Francisco

IPO or IOU?

Despite its gold-standard brand and $1 trillion in purchase volume, MasterCard's blockbuster IPO has its risks:

LEGAL BATTLES

- Some $650 million of IPO proceeds will be used to pay legal bills to defend against 38 lawsuits over MasterCard's fees and other suits. It has no other legal reserves.
- Discover and American Express are suing MasterCard on antitrust issues
- Cardholders are suing the company over its currency conversion practices and alleged billions in overcharges

INDUSTRY OBSTACLES

- Continuing consolidation in banking and retailing is allowing big customers to negotiate lower processing rates, squeezing profits
- Investor interest in financial IPOs is waning because the Fed is hiking rates and consumer credit quality is in question
- MasterCard is extremely weak in PIN-based debit transactions, which are growing faster than credit
- The move into processing is ill-timed: Big banks are bringing processing in-house
- Upstart players—from the online processing outfit PayPal to cell phones—are encroaching on all players

Data: MasterCard International Inc. *BusinessWeek*

Investors May Not Want This Hot Line

CEOs are leading a charge to get brokers to cough up the names of shareholders

BY AMY BORRUS

BIG BUSINESS WANTS TO reach out and touch someone: its far-flung owners. Executives, bombarded by a fusillade of shareholder resolutions and challenges to directors, want to break down the barriers that keep them from communicating directly with stock owners. Who could oppose such a plea for openness? Well, investor activists, institutions, and brokers, for starters. They see a power grab by business to tilt the messages shareholders receive and, perhaps, compromise investor privacy.

Activists see a grab by execs to control the flow of info

The dispute turns on a little-known fact: More than 80% of shareholders keep their holdings in "street names," registered to their bank or brokerage. The vast majority of these investors elect to remain anonymous to corporate management. To send out annual reports, proxy statements, and management broadsides, brokers rely on Automatic Data Processing Inc. (ADP), a Roseland (N.J.) outfit that has a virtual lock on the business.

Now a coalition led by the Business Roundtable, a group of big-company CEOs, is trying to wrest control from ADP. It is urging the Securities & Exchange Commission to force brokers to cough up names so companies can make their pitch directly to shareholders. Stock owners who insist on anonymity would pay for the privilege. "Our objective is to make

[communications] more efficient and empower shareholders with more information on a more timely basis," says Thomas Lehner, the Roundtable's director of policy for corporate governance.

But more is at stake than smooth communications. Some investor advocates are pressuring the New York Stock Exchange to jettison a rule that lets brokers cast the proxies of investors who don't vote. These "broker nonvotes"—15% to 20% of tallies—nearly always back management. Companies don't want to lose that support without gaining a way to woo shareholders personally.

Business sees an opening at the SEC, now led by tech-savvy Chairman Christopher Cox. On Nov. 29, the agency plans to propose new rules that would let companies post proxy materials on their Web sites instead of sending them via snail mail. Business hopes that will open the door for its plan. Commission Paul S. Atkins would like to see the SE hash out the issue. "I'm sympathetic [the Roundtable's] petition for new rule We need more openness in shareholder communications," Atkins says.

THE STAT

80%

of shareholders hold stock in "street names" rather than registering with the issuing company

Data: Automatic Data Processing Inc

"COUNTER-REVOLUTION"

INSTITUTIONAL investors and broke say business has power, not communic tions, in mind. "This is the corpora world's counter-revolution," says Greg Kinczewski, general counsel for Marc Consulting Group, a Chicago-based in vestment adviser. "Do you want the pe ple who brought us the scandals to be i charge of a process that's supposed to b fair and trustworthy?"

Activists fear that business controlled acces to shareholders, manager might stall mailings by dis sidents or demand rewrite of critical comments. "T would be very easy fo companies to put seriou obstacles in the way o communications betwee shareholders and meddl with content," says Damo A. Silvers, associate genera counsel for the AFL-CIO.

Brokers are loath t hand over proprietary cus tomer information an doubt that many accoun holders would appreciate spam or din nertime phone calls urging them to vot with the CEO. Brokers also like ADP's un biased, one-stop service and shudder a the prospect of sending data to new firm that companies hire to handle mailings.

To protect its perch, ADP has investe more than $100 million in its systems i the past decade and eliminated 41% o paper mailings at a $700 million annua savings. "We can distribute electronicall to 70% of shareholders within 24 hours," says Chuck Callan, vice-president for regulatory affairs at ADP Investor Communications Services. Business groups pushing for change haven't spelled out how they would do better. But with dissident shareholders gaining ground—they won majority support on 20% of their 2005 proposals—companies figure they need a stronger hand. ■

–With Mike McNamee in Washington

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OFF AND RUNNING Hsieh has doubled sales yearly with minimal advertising

A Shine On Their Shoes

Zappos.com's blue-ribbon customer service is winning market share

BY KIMBERLY WEISUL

TONY HSIEH, CEO OF e-tailer Zappos.com, became a serial entrepreneur earlier than most. At age 12, he ran a business making buttons by sealing photos between a sheet of plastic and a metal disk. After advertising in a directory aimed at other kids, he was soon bringing in a few hundred dollars a month. By college, Hsieh was selling pizzas out of his Harvard dorm. Another student, Alfred Lin, was equally enterprising: He bought whole pizzas from Hsieh and resold them by the slice.

So it's not surprising that, at 31, Hsieh is already on his second grown-up gig as CEO, with Lin as his CFO. His company sells shoes online, differentiating itself by its selection—some 90,000 styles and more than 500 brands, from Bass to Givenchy—and a near-fanatical devotion to customer service. Shipping and return shipping are free; most repeat customers get upgrades to free overnight or second-day delivery. "With Zappos, the shoe store comes to you," says Pamela Leo, a customer in Montclair, N.J. "I can try the shoes on in the comfort of my own home. I can tell if the shoes I want will really work with a particular suit. It's fabulous." Hsieh, loath to advertise, has relied on such word of mouth to help double Zappos' sales every year for the past six, to a projected $350 million this year. He says Zappos will become profitable next year.

Other retailers are just now seeing the dot-com in their rearview mirror. "The [footwear] industry was in shock when they found out the numbers Zappos is doing and how popular they are," says Miles Olson, an independent sales representative for Simple Shoes and UGG Australia. Zappos has plenty of fuel for further growth: In June, Sequoia Capital added $15 million to an earlier $20 million investment.

Hsieh's preoccupation with service started at LinkExchange, which he started in 1996 to let small Web sites barter for banner ads. At a time when many companies let customer e-mails go unanswered, Hsieh started customer-servi team to mak sure every e-ma got a response.

A cold call from Zappos founder Nic Swinmurn brought Hsieh to the compan After selling LinkExchange to Microso Corp. for $265 million in 1998, Hsieh ar Lin formed a venture fund. Swinmurn le them a voice mail about Zappos, addin that shoes were a $40 billion market in th U.S., of which $2 billion were sold by ma order. That got Hsieh's attention. Ov time, he and his fund invested about $1 million. After a stint as Swinmurn's co CEO, Hsieh became CEO in 2000.

FREE LUNCH

WITH FRED MOSSLER hired from Nord strom Inc. to head up merchandising Hsieh says a service emphasis "evolve very naturally." At Zappos, custome service employees don't use scripts an aren't pressed to keep calls short. Hsie says customer loyalty is so important t the company culture that the call cente and headquarters have to be in the sam place—Las Vegas. Every new hire spend four weeks as a customer-service rep an a week in the Kentucky warehouse befor starting work. Staff is treated well Health insurance premiums are 100% company-paid (though employees con tribute to dependents' premiums). All 650 employees, from execs to warehous workers, get a free lunch every day.

That warehouse is open 24/7, so cus tomers can order shoes as late as 11 p.m and still get next-day delivery. "If cus tomers know that they're going to get th best service from Zappos and they're go ing to get it overnight, then anytime we'r going to add a product category, our cus tomers will be loyal to us," says Hsieh.

Zappos tries to treat its vendors equally well. The company's extranet lets vendors see which shoes are selling and how profitably. "I can see my business from their point of view," says Tom Austin, who manages the California and Nevada territories for Clarks Companies North America. "Fred [Mossler] just says, 'I don't want to run out of shoes, you take care of us.' You can't believe how pleasant they are to work with." Zappos even holds a vendor appreciation party before the big industry trade show each year. And yes, the call center staff are all invited. ■

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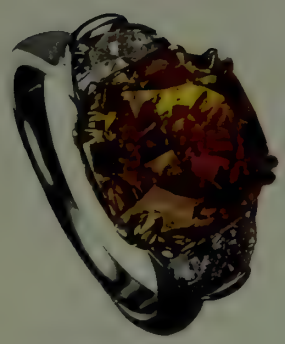
The Color Of Ice

Gemstones in a riot of hues are red-hot—everything from pink topaz to lemon citrine to jadeite. **BY KATE MURPHY**

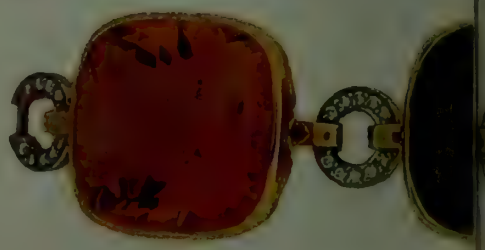


ORANGE A 5½-carat diamond from Harry Winston at $3 million

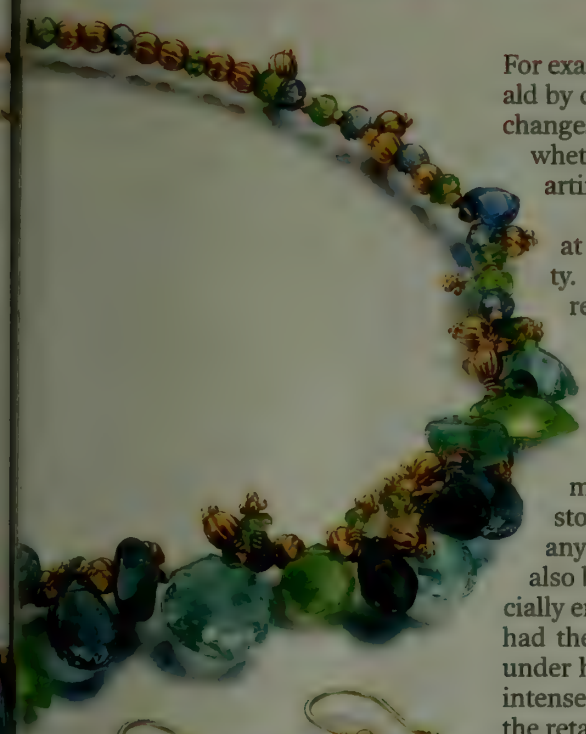
ONE OF THE FEATURED PIECES in the Harry Winston jewelry collection this fall is a $3 million ring with a 5½-carat diamond between two smaller shield-shaped stones. It's big and blindingly bright. But perhaps the most striking thing about it: The middle diamond is orange. ¶ Colored gemstones are red-hot. Available in a variety of shades, grades, and price ranges, they are being incorporated into everything from teardrop earrings to bulky bangles and Renaissance-inspired collars. The broad palette allows you to buy jewelry that will flatter someone's coloring or match a favorite outfit—making for a more personalized gift. ¶ "I haven't seen this much interest in color in the 40 years I've been in business," says Louis Tennenbaum, a Houston jeweler who says pink and green semi-precious stones such as morganite and peridot are especially popular in "sporty settings reflecting today's more relaxed lifestyle." ¶ Scarcity and fashion dictate the cost of colored stones. Diamonds come in yellow, pink, blue, and yes, orange. But they are extremely rare and can cost hundreds of thousands of dollars per carat (one-fifth of a gram). High-quality emeralds, sapphires, and rubies are more likely to run thousands of dollars per carat. Other lesser known varieties such as black opal, pink topaz, alexandrite, jadeite, and pink sapphires cost $250 to $5,000 per carat. So called semi-precious stones like lime green tourmaline, sky-blue aquamarine and mandarin-orange garnet are in the range of $50 to $500 per carat.

Assessing the quality of most colored stones is much easier than appraising a diamond, which requires a trained eye and magnification. The most important determinant of quality is the brilliance of the color. "The richer and more vivid the color, the more valuable the stone," says Douglas Hucker, executive director of the American Gem Trade Assn., based in Dallas. Clarity

BRACELET Stones in a cushion cut from Samuel Getz at $20,500



(CLARKWISE FROM TOP) COURTESY LAURA GIBSON; COURTESY HARRY WINSTON; COURTESY SAMUEL GETZ; COURTESY HARRY WINSTON



ECKLACE SET
lue topaz,
reen quartz, and
quamarine

n't so important because
nperfections in colored stones,
alled inclusions, can make them more
nteresting, like the "stars" in star sap-
hires or "cat's eyes" in cat's-eye
hrysoberyl. A fantastic cut that shows off
he color by reflecting more light back to
he eye doesn't necessarily increase a
tone's value, but it doesn't hurt.

When making a choice, line up several
xamples of the same gemstone side by
ide to see which is the most radiant.
Hucker says most people will pick the
est-quality gem when allowed to make
omparisons. Because some stones may
hange color in different kinds of light-
ng, Scott Gordon, a jeweler in Oklahoma
City, recommends looking under natural,
ncandescent, and fluorescent lighting to
make sure you get the shade you want.

For example, alexandrite is called "emerald by day and ruby by night" because it changes from green to red depending on whether it is viewed under natural or artificial light, he says.

You can hire an appraiser to look at a stone to assure you of its quality. But you're better off going to a reputable jeweler who will guarantee the stones and take them back if you're not satisfied. If you're buying colored gems online or from a home-shopping channel, you won't be able to make side-by-side comparisons of stones, so make sure you can return any item for a full refund. You should also be aware that stones can be artificially enhanced—such as a ruby that has had the element chromium added to it under high heat to make it appear more intensely red. If that concerns you, ask the retailer about it.

Many well-known jewelry designers are using a full spectrum of stones in their creations. New York-based Harry Winston, which has boutiques all over the world (harrywinston.com), sells diamonds in every color of the rainbow for prices that arc about as high. Samuel Getz in Coral Gables, Fla., (samuelgetz.com) features similarly clean, classic designs but tends to use more unusual stones and color combinations such as an emerald-cut aquamarine ring with triangular-shaped rubellites (a red tourmaline) on either side ($12,500). His multicolored gem bracelet is a series of cushion-cut stones like lemon citrine, smoky quartz, and rubellite set in 18-karat yellow gold ($20,500).

Laura Munder in Palm Beach, Fla., (lauramunder.com) creates pieces that are a near-riot of color. Some of her bracelets have a kaleidoscopic quality with crazy mixtures of pastel tourmalines, pinkish kunzite, and aquamarine ($21,300). More geometric is her cuff-style bracelet with rectangular-cut rhodolite, peridot, iolite, citrine, and blue topaz arranged in a grid ($53,250). Laura Gibson in Tucson (lauragibson.com), likes to cluster stones together, which creates a nubby jumble of color. You'll find combinations such as lemon and blue topaz, citrine, peridot, and chrysoberyl. Necklaces cost $2,000 to $5,000, with matching earrings for $250 to $1,000.

TRADITIONAL
Pear-shaped emerald-and-diamond earrings

You can also get some of David Yurman's designs for under $1,000 (davidyurman.com). A pink-tourmaline-and-diamond sterling silver bangle costs $800, and a pair of sterling silver earrings set with your choice of stones like citrine, black onyx, or blue topaz costs $425. To make more of a statement, you can spend more than $16,000 on Yurman's bold 18-karat gold Renaissance-style collar with citrine, smoky quartz, lemon citrine, pink tourmaline, olive citrine, and cinnamon citrine. Colorful and sparkling, a gift like that can truly light up the holidays. ■

BusinessWeek weekend

For more on many of the products in our Gift Guide watch BusinessWeek Weekend. Check your local TV listings or go to businessweekweekend.com to view this and other stories from our weekly TV program.

Tomes for The Holidays

This season's coffee-table books are for aficionados of everything from golf to Van Gogh. **BY THANE PETERSON**

ELLIOTT ERWITT IS A LEGendary photographer best known for his iconic Cold War shot of Vice-President Richard Nixon poking a finger in the chest of Soviet leader Nikita Khrushchev. So why is Erwitt's latest photo collection called **Woof**? Because he loves dogs, of course, and this selection of candid, funny canine shots makes for a great holiday gift (Chronicle Books, $22.95). If none of your friends and loved ones gives a hoot about hounds, there are other good coffee-table books out this fall for aficionados of everything from sports and comic books to Africa and Paris.

For starters, National Geographic Books has two memorable new books on Africa. **The Last Place on Earth** ($150) is a two-volume boxed set. The wildlife photos by Michael Nichols in Volume I were taken over 12 years, many of them during an arduous 456-day trek through uncharted regions of Congo and Gabon in 1999 and 2000 with ecologist J. Michael Fay, whose account of th trip provides the text for Vo ume II. The photos help spur Gabon President Om Bongo Ondimba to set asi 11,300 acres for parks an animal preserves. Anoth perspective is found **Through the Eyes of the God An Aerial Vision of Africa** ($5 by Dallas leveraged buyo specialist, photographer, an conservationist Robert Haas. Taken from helicopte and light planes, the phot range from a brutal image a crocodile devouring prey to beautiful high-u views of rivers, jungle, an shantytowns that resemb abstract paintings.

A nature book childre will love is **Vanishing A** (Bulfinch Press, $50), which photographer A Wolfe shows animals camou flaging themselves. It's fun search out the owls, lion and harp seals hidden in h scenes.

Among the best ne books for art lovers is **Andre Wyeth: Memory and Mag** (Rizzoli, $49.95). Publishe in conjunction with a maj museum retrospective (now at Atlanta High Museum), it demonstrates wh Wyeth's often monochromatic painting are so popular. His best portraits are ser sitive and revealing, and few artists inve empty landscapes and homey object with such a palpable sense of mystery.

Van Gogh: Master Draughtsman (Abram $40) shows the drawings of an arti known for his paintings. It's interesting t learn that the insecure and self-taugh van Gogh often referred to how-to-dra books for help with his technique.

Gridiron fans will get a kick out **Sports Illustrated: The Football Book** (Sport Illustrated Books, $29.95), which collect the magazine's best writing and photo about the game. Its lists of the best player are sure to spark debate, and the writin by scribes such as Dan Jenkins and Georg Plimpton is marvelous. A nostalgia trip fo baseball fans is **Smithsonian Baseball: Insid the World's Finest Private Collections** (Smith sonian Books, $29.95). Its 350 photos an 21 profiles cover everything from vintag cards, posters, and autographed balls t jerseys once worn by sluggers such as Jim mie Foxx and Jackie Robinson.

Ambitious golfers will go for **Golf's 10**

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Toughest Holes (Abrams, $45). Some of the killer holes are at famous courses such as Pebble Beach in California and St. Andrews in Scotland, but golf writer Chris Millard also ferrets out many at lesser-known clubs, such as the Hallbrook Country Club in Leawood, Kan., with its daunting 454-yard, par-4 seventh hole. Chances are, most readers will find a few within driving distance (by car, not 3-iron).

CELLULOID DREAMS

THE 560 black-and-white photos in **Robert Doisneau: Paris** (Flammarion, $60) form a personal portrait of the French capital from World War II until a few years before the photographer's death in 1994. Doisneau's exquisite timing and sly humor are evident in shots such as one of a worker in coveralls and plaid slippers doing a headstand in a bistro. You can find an astonishing collection of historical photos in **Augustus F. Sherman, Ellis Island Portraits 1905-1920** (Aperture, $40). Taken by a registry clerk, the images belie the stereotype of immigrants as cowed "huddled masses." From Romanian shepherds to a Turkish bank guard, many clad in their national garb, these immigrants look confident and eager to seek their fortunes.

A truly sublime photo book about China is **Celestial Realm: The Yellow Mountains of China** (Abbeville Press, $55). The Tokyo-based China-born lensman Wang Wushen has been photographing the Yellow Mountains in northern China for 30 years. His delicate, black-and-white photos echo the themes of similar scenes in classic Chinese paintings and scrolls.

Lovers of stage and screen will want to check out **A Fine Romance: Hollywood/Broadway (The Magic. The Mayhem. The Musicals)** (Watson Guptill, $45). It's a chatty account of the making of musicals such as *Sunset Boulevard*, *West Side Story*, and *The Producers* that were both Broadway shows and Hollywood movies. Author Darcey Denkert, who works for MGM, has an ear for the catty quote. For instance, in her discussion of *Sunset Boulevard*, she quotes a composer as saying: "[Andrew] Lloyd Webber's music is everywhere—but so is AIDS."

For those who love design, check out **American Streamlined Design: the World of Tomorrow** (Flammarion, $75). It documents all that was sleek and aerodynamic in American design from the 1920s through the early 1960s. There's everything from Silvertone Streamline radios and colorful Fiesta dishes from the 1930s to sleek Osterett hand mixers and IBM Selectric typewriters from the 1950s and 1960s. Another beautiful design book is **Comprehensively Clarice Cliff** (Thames & Hudson, $95), the first complete compendium of the Art Deco ceramics created by the English designer from the 1920s through 1950s. Cliff's colorful plates, bowls, and vases now fetch as much as $50,000 from collectors.

Masters of American Comics (Yale University Press, $45) offers a serious look at an amusing subject. It demonstrates the artistry of such cartoonists as George Herriman (who created Krazy Kat), E.C. Segar (Popeye), and R. Crumb (of Zap Comix fame), with examples and lively essays by everyone from *The Simpsons* creator Matt Groening to Pulitzer Prize-winner Jules Feiffer. Of course, Charles Schulz's Snoopy is there, too. The holidays wouldn't be the same without Charlie Brown's button-nosed beagle. ■

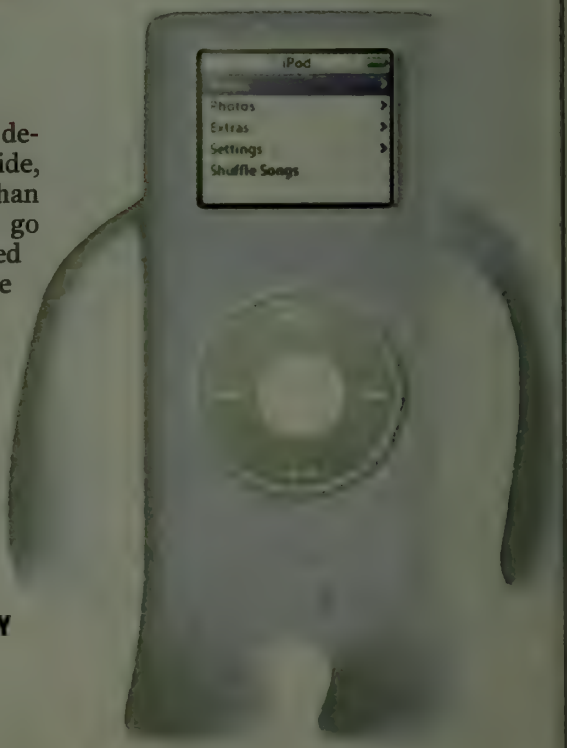
The iPod: All Decked Out

A host of accessories for the new nano and its video-playing cousin—even a tiny Santa suit—is just a click away. **BY JAY GREENE**

APPLE'S UPDATES OF its wildly popular iPod line this year didn't just give consumers another reason to buy the music player. It gave them—and friends and family members who plan to give gifts—a new bounty of iPod accessories to choose from as well.

That's because the design of the iPod nano and the video iPod means many of the old accessories can't be used with the new devices. Both require new cases, for example. With the nano, it's easy to see why. The incredibly thin device is a completely different shape than the iPod mini, which it replaced. But even its video cousin, which is the same size as the previous-generation non-video iPods, needs a new wrap. That's because the headphone jack on the top of the device moved from the center to the side, and the screen is a great deal larger than earlier versions. No owner should go case-less. Consumers have complained about how easily these devices are scratched, particularly the nano.

There already are some slick cases on the market. My favorite for the nano: WaterField Designs' $22 case (sfbags.com). It has a subtle checkerboard pattern weaved into the nylon on the outside and a cushiony neoprene liner to protect the device. But the thing that sets it apart is a wide elastic strap on one side to stow your headphones when the nano is not in use. Incase makes the stylish $20 nano



MR. PERSONALITY Speck's iGuy stand

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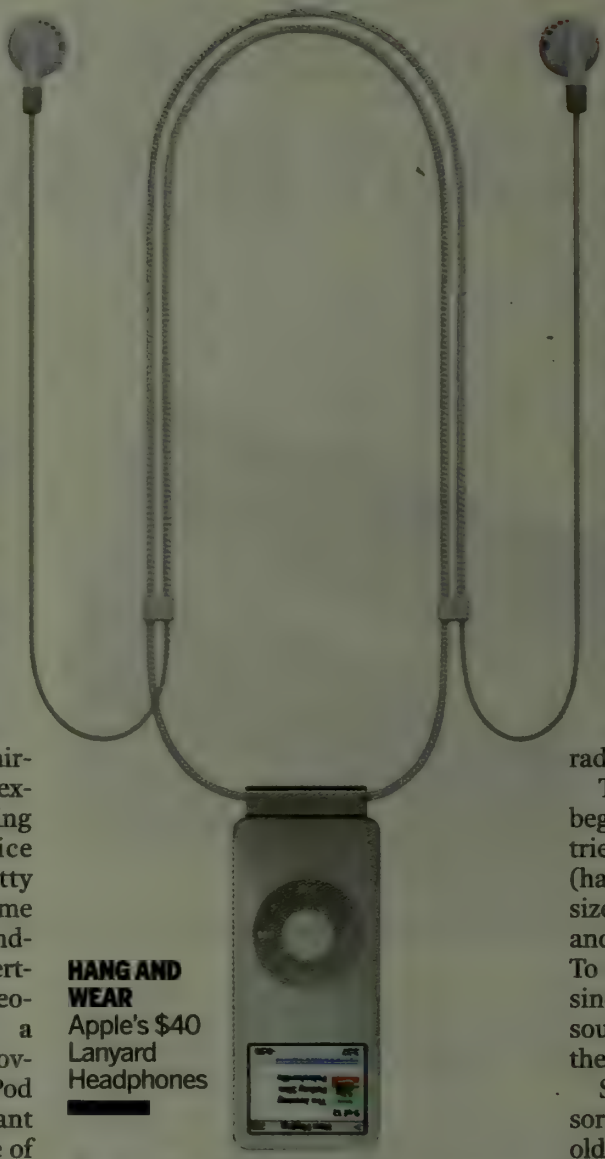
Wallet in black or pink leather. It comes with a compartment on the flap to stash credit cards (goincase.com). Marware has the most whimsical offerings with its $20 Sportsuit Safari, a protective sleeve that comes in seven faux-fur styles, including giraffe and zebra (marware.com). To dress up a nano under a tree, Marware offers the seasonally appropriate Sportsuit Santa, a $20 plush red case trimmed with white fur.

WILD THING
Marware's Sportsuit Safari case

The video iPod is new enough that only a handful of cases are available for it. The best is Belkin's $30 Kickstand Case, a leather cover that opens and folds in half to become a stand allowing a viewer to watch videos on an airplane tray table, for example, without having to hold the device (belkin.com). Pretty slick. Marware has come out with its tried-and-true Sportsuit Convertible for $40, a snug neoprene case with a protective flap that covers the face of the iPod and an all-important pocket on the outside of the flap to stash the earphones.

Just about any earphone will work with the new iPods. But for the nano, take a look at Apple's nano Lanyard Headphones (apple.com). A little pricey at $40, they snap into the headphone jack and dock connector at the bottom of the nano and let you wear the iPod around your neck. It even hangs upside down, allowing users to flip the player up and not have to read an upside-down screen.



HANG AND WEAR
Apple's $40 Lanyard Headphones

BASE STATION
DLO's $100 HomeDock

Accessory makers are just beginning to devise clever ways to take advantage of the video iPod's capabilities. One of the best is Apple's QuickTime 7 Pro software. At $30, it gives home-video buffs tools to convert their home movies into files that can be downloaded to and played on an iPod.

Sharing video is easy, too—with the right gear. A must-have is the $19 AV Cable, also from Apple. The cable, which connects your iPod to the red, yellow, and white composite RCA jacks on a TV, was originally intended to play slideshows from last year's iPod Photo on TV. But it handles video, too. Want to go higher end? Try Digital Lifestyle Outfitters' $100 HomeDock, a base station that links the iPod to a home theater system, pumping the video's accompanying soundtrack through stereo speakers (dlo.com).

Anyone who gets carried away with video will soon discover it taxes the iPod's battery far more than music does. The 30 gigabyte iPod runs out of juice after just two hours of video play. That means anyone planning to use it on a long-haul flight will appreciate Nyko's iBoost, a $70 battery pack that can add another 7 hours of video playtime (nyko.com).

For anyone with an iPod, listening to your music in the car has become very easy. Griffin Technology's iTrip FM Transmitter, which shoots music over airwaves to an unused FM radio signal, has set a standard for elegant design (griffintechnology.com). Its earlier models took advantage of the remote port on the top of previous generation iPods, but Apple has eliminated that port with the new breed. So Griffin has come out with a new iTrip, at $50, that snaps into the dock connector at the bottom of the new iPods. Be forewarned, though: FM Transmitters don't work particularly well in urban areas with packed radio dials.

The iPod toy category is one that's just beginning to bloom. One of the early entries: the $30 I-Dog from Hasbro (hasbro.com). Plug an iPod into the pint-size robotic canine and watch it light up and turn different colors to your music. To be fair, it's not purely an iPod item, since it will connect to most music sources. But the name clearly suggests the market it's targeting.

Some new accessories work with the old iPods as well, such as the $100 iHome clock radio (ihomeaudio.com). Just pop an iPod into the iHome's dock to wake up to favorite tunes. The gadget even charges the unit overnight and serves as a speaker system, too.

THE NATURE LOOK
Grass FunSkin from Speck

Speck Products seems to have cornered the market on iPod silliness (speckproducts.com). Slip a nano into the $35 iGuy stand, and all of a sudden it's goofiness personified. The rubber stand has a cartoonish body with movable arms. Speck's $35 Grass FunSkin is a case designed to look like grass is sprouting from a nano. It's hardly the most functional iPod accessory. But that's not really the point, is it? ■

PROFESSION: PILOT
CAREER: ACTOR

Photographed by Patricia von Ah on the private runway at the Travolta residence in Ocala, Florida.

"I LIKE TO FLY AT LEAST ONCE A DAY."

People are acquainted with the star, the multi-faceted actor. But John Travolta is also a seasoned pilot with more than 5,000 flight hours under his belt, and is certified on eight different aircraft, including the Boeing 747-400 Jumbo Jet. As a young boy in New Jersey, he already used to dream of flying as he watched planes criss-crossing the sky around the New York airports. Today, John Travolta travels the world at the controls of his own airliner and nurtures a passion for everything that embodies the authentic spirit of aviation. Like BREITLING wrist instruments. Founded in 1884, BREITLING has shared all the finest hours in aeronautical history. Models such as the NAVITIMER have become cult objects for pilots the world over. Where safety is of crucial importance, BREITLING is known as the specialist in reliable and high-performance "wrist instruments" designed and tested for the most demanding professionals. BREITLING chronographs meet the highest standards of sturdiness and functionality and are equipped with movements that are chronometer-certified by the COSC (Swiss Official Chronometer Testing Institute) – the highest reference in terms of precision and reliability. One simply does not become an aviation supplier by chance.

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How to Uncork The Web

Ordering wine online is a cinch. Shipping it can be trickier. **BY DAVID KILEY**

THE WINE ENTHUSIASTS I know would much rather receive desirable cabernets or Champagnes from their long-distance friends and relatives than any of the new ice buckets that too often arrive on the doorstep. Sending wine by mail via the Internet, while getting easier, still takes some knowhow and comparison shopping to satisfy both giver and recipient.

If you know someone has a favorite winery, especially if it's small and its wines are not widely distributed, call to see if bottles can be shipped direct. The U.S. Supreme Court ruled earlier this year that wineries, hobbled by a web of state laws restricting direct shipping, are now free to do so. But states are still wrestling with the decision, and not all the barriers are down. Napa Valley's Charles Creek Vineyards, for example, still ships to just 14 states, but notes on its Web site: "The laws in other states are constantly changing, so please call the winery."

Shipping from one of the many online merchants, such as Wine.com or Winelibrary.com, is just as challenging. Wine.com ships wine to 23 states, although it sends edibles, corkscrews, and the like nationwide. So before investing time in choosing bottles, go straight to the shipping-policy tab on a seller's Web site to see if you can send the wine to your friend in, say, New York (yes) or Vermont (no). Alaska, Florida, and Idaho actually restrict direct wine shipments by zip code.

Wineweb.com, which sells wines directly from wineries—many of them small—is handy because it allows a search based strictly on what state you're shipping to. Mywinesdirect.com, which currently ships to 26 states, specializes in small wineries with limited or no retail distribution and offers free shipping as well.

Now that you know how to buy, you have to decide what to buy. Gift certificates are easiest. And all of these sites have plenty of suggestions. But stay away from gift baskets that stipulate the shipper will make a selection of, say, "six wines from California." It's your money, so know what you are buying.

Thoughtful gift-giving should incorporate more creativity than that anyway. If your friend or relative has been nattering on about pinot noir ever since seeing the movie *Sideways*, introduce her to a similar medium-bodied red like Amarone, from the Veneto district in northeast Italy. At Wine.com, I found three: a 2000 Allegrini for $60, a 1997 Bertani for $80, and a Zenato 2000 for $52. It pays to comparison shop. That same Bertani '97 was just $58 and the Allegrini $50 at Winelibrary.com. Shipping for three bottles runs $15 to $20 depending on the destination.

Whatever you do, don't be tempted to get a wine enthusiast a fancy $50 or $100 corkscrew. Any oenophile worth his spitbucket would rather have the wine. ■

BusinessWeek online For more on holiday wine gifts, go to www.businessweek.com/extras

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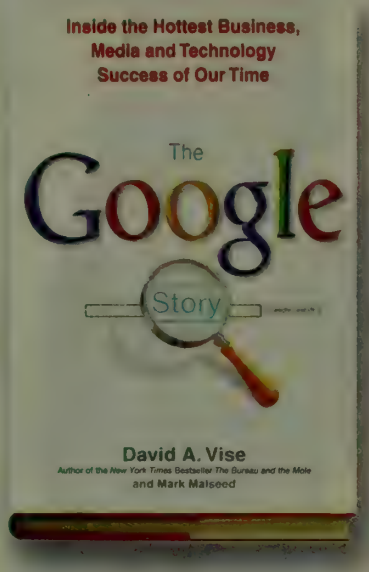
Inside the Hottest Business, Media and Technology Success of Our Time



Pulitzer Prize winner David A. Vise and writer Mark Malseed reveal THE GOOGLE STORY in full, from two students' "healthy disregard for the impossible," to the real scoop on the success story you think you know, to new frontiers in human genetics!

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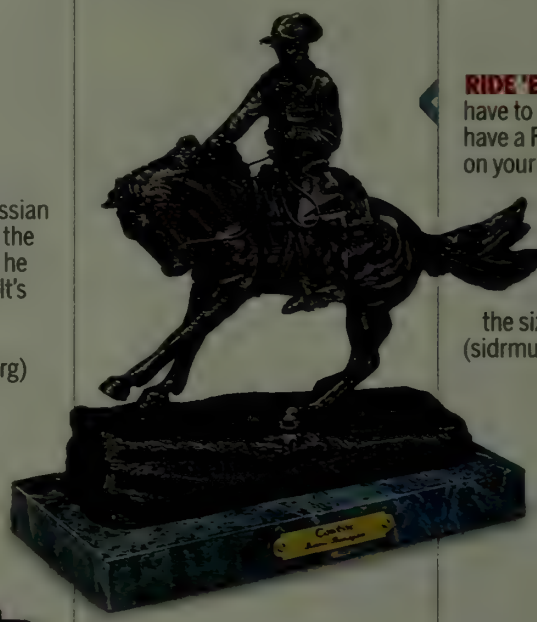
The Art of Giving

You don't have to buy cookie-cutter presents. There's a world of collectibles waiting to be discovered at online museum shops. **BY MONICA ROMAN GAGNIER**

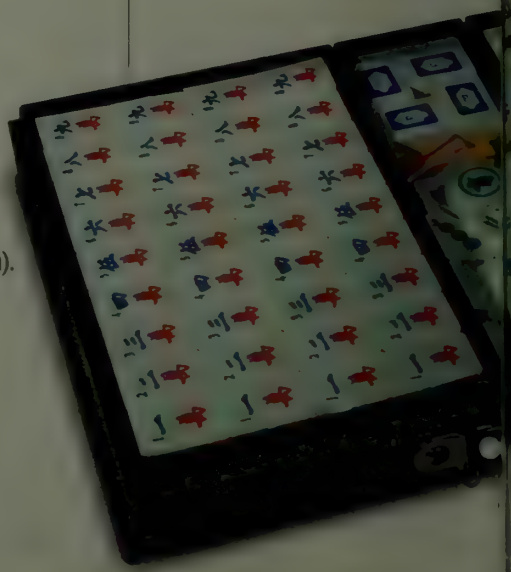
LOOKING FOR SOMETHING UNUSUAL for those folks who have everything? Instead of jumping in the car and heading for the mall, power up your laptop and let your fingers do the shopping at the online stores of American museums. Here's an eclectic sampler of holiday gifts that people can wear, carry, display, or play with. Some of these items are one of kind; all are out of the ordinary.

GO NUTS! This colorful Russian fellow could have served as the muse for Tchaikovsky when he composed *The Nutcracker.* It's $315 at the Philadelphia Museum of Art (store.philamuseumstore.org)



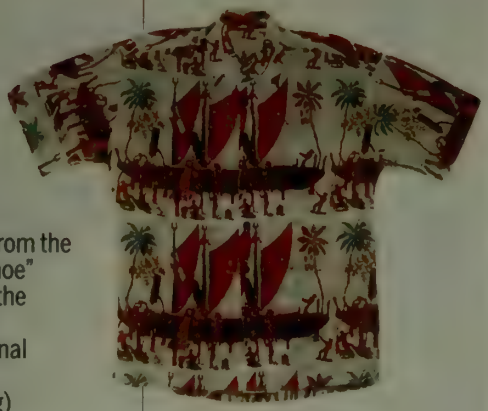
RIDE 'EM COWBOY You don't have to be a corporate raider to have a Frederic Remington sitting on your desk. Replicas of "The Cowboy" are available from the Sid Richardson Museum in Fort Worth for $240 to $1,500, depending on the size you want (sidrmuseum.org).

TRIBAL TERRITORY These 23-in.-by-44-in. textile rugs, offered for $25 by the Brooklyn Museum, were inspired by raffia cloth squares once used as currency in the Kuba kingdom of Africa (shop.brooklynmuseum.org).



GET LUCKY Don't settle for a cheap imitation of a Mah-Jong set when you can get the real thing for $80 at the Smithsonian (freersacklershop.com).

(NUTCRACKER) COURTESY THE PHILADELPHIA MUSEUM OF ART; (RUGS) COURTESY THE BROOKLYN MUSEUM; (COWBOY) COURTESY THE SID RICHARDSON MUSEUM



SURF'S UP Here's an authentic Hawaiian shirt for the Big Kahuna in your life. Proceeds from the sale of the $66 "Canoe" rayon shirt support the Bishop Museum of Honolulu's educational programs (bishopmuseum.org)

IN THE BAG Anyone carrying this geometric purse adorned with carved coconut shell disks and squares will feel right at home in the urban jungle. The Los Angeles County Museum of Art sells it for $88 (earthstores.com/LACMAstore).

FIT FOR A KING These 24-karat gold-plated cuff links are replicas of 14th-century melon bead ornaments found in Prague's Karlstejn Castle. They're $30 a pair at the Metropolitan Museum of Art (metmuseum.org/store).

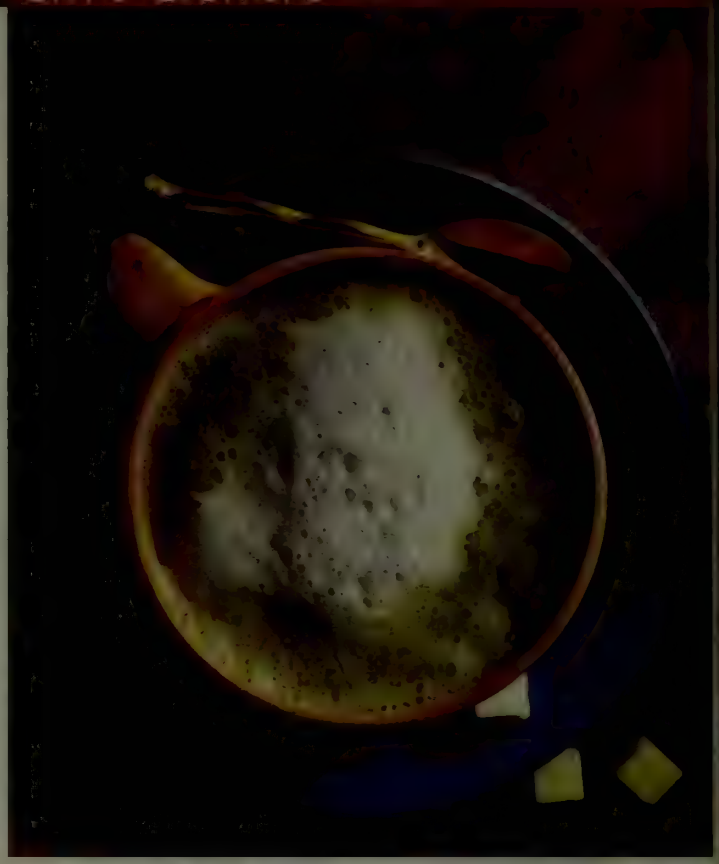
HEAVENLY HELPER This $2,200 carved angel by Santa Fe artist Frankie Nazario Lucero will watch over your loved ones. You can buy it from Museum of New Mexico Foundation Shops (shopmuseum.com).

OBJET DE GOLF Artist Ray Mathews Jr. designed this glass putter with a True Temper steel shaft to meet U.S. Golf Assn. specs. He and others use it on the course, but it also makes a nice decoration for the den or office. It's $175 at the Corning Museum of Glass (glassmarket.cmog.org).

(MAH-JONG, CUFF LINKS; HANDBAG, AND GOLF CLUB) BY DAVID RUDES/BW; (SHIRT) MARK BROWN/THE BISHOP MUSEUM COLLECTION; (ANGEL) CANDACE ALLEN/MUSEUM OF NEW MEXICO

Haute Chocolate

These luscious mugfuls are a far cry from instant. **BY LAUREN YOUNG**



CALL IT HOT CHOCOLATE or drinking chocolate, but don't dare call it cocoa. That's the sweet, watery drink made with the brown powder often found in single-serve packets. The hot chocolate we're talking about is more like a dessert. It's smooth, luscious, and may not even be sweet. "Hot chocolate is a little bit sinful," says Lan Wong, founder of Les Amusettes, a chocolate-tasting firm in Oregon's Walla Walla Valley. That's why it's a great gift.

To understand the essence of real hot chocolate, we tested eight specialty brands ranging from $13 to $24. This arduous assignment required six *BusinessWeek* colleagues and me to attend two in-office tastings and to brew cups at home.

Before we reveal the winner, here's a little history: The Aztecs, who were among the first consumers of chocolate, liked to drink it cold, spiced with chilies and wine. The hot chocolate we know and love today was born in the 1500s, after Spanish explorers brought cacao beans home from the New World.

Hot chocolate is made from ground-up chocolate pieces—its cocoa-butter base adds flavor and texture. The chocolate is often brewed with steamed whole milk, although some recipes call for water.

In our quest to find the perfect cup, we asked leading chocolatiers to send us their most popular varieties and followed each brand's recipe. All are available online.

Despite its generic tin, Eli Zabar Swiss Premium caught our tasters' attention because it came with a container of fluffy marshmallows—and, at $24, it was the most expensive of the bunch. It was too sweet for most of us, which probably explains why it was the top choice among our kids, ages 10 and under. We liked eating the small pieces of Recchiuti Dark Hot Chocolate out of the box, but when mixed with water, it was too bland. Chocolat Moderne Midnight Oasis earned points for its pretty Turkish-inspired packaging, but reviewers said it had "no bite." Sans Souci Chocolate Elixir, which comes in a homey jar, was "creamy and smooth."

UNCONVENTIONAL THINKING

WE ALSO SAMPLED an organic blend, Dagoba Authentic Hot Chocolate. It was simply too sugary. From among Schokinag's offerings, which include nine varieties, we chose best-selling Triple Chocolate, finding it "pleasant" and "comforting."

Ultimately we narrowed our favorites to two brands: Jacques Torres Classic ($16 for an 18-oz. tin) and MarieBelle Aztec ($17 for a 10-oz. tin). While Jacques Torres (who used to make chocolate for MarieBelle) got high marks for being ultra-thick, a blind tasting of both revealed MarieBelle as the favorite. One of our tasters said it was like "drinking a dark chocolate bar." MarieBelle's French blue-and-brown tin is "definitely giftable," noted another reviewer, who bought it for his wife the next day.

Sold at mariebelle.com, MarieBelle's is made from flavorful Venezuelan and Colombian beans. "It's an indulgence," says Michael Turback, author of *Hot Chocolate* (Ten Speed Press). While treating your friends to a luxurious gift, why not indulge in some chocolate yourself? ■

Tchocolate Tchotchkes

SPA SAMPLER

Made with fruits and nuts, Bissinger's new Spa Chocolate Week 2 ($16) gives you a 50-calorie treat for each day of the week (bissingers.com).

COOKBOOK

Hot Chocolate by Michael Turback ($10) gathers more than 60 recipes using ingredients like lavender and cayenne.

BITES

Artist Mike Hammer designed the colorful tins for Sweetriot's intense dark chocolate nibs, which feature a kick of espresso ($6, sweetriot.com).

FROTHER

Use the Aerolatte to make froth for your hot chocolate (or cappuccino and milk shakes). It's $20 at Bed, Bath & Beyond and other specialty retailers (aerolatte.com).

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BY GENE G. MARCIAL

McDONALD'S WILL BE SERVING COFFEE FROM GREEN MOUNTAIN.

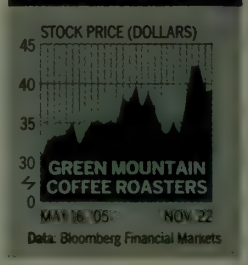
FEDERAL REALTY'S LOCATIONS MAKE IT A "BEST-IN-CLASS REIT."

CARRYING COAL AND IRON TO BOOMING ASIA: GENCO SHIPPING.

Green Mountain: Perking

ALTHOUGH COFFEE IS A tough business, investors have awakened to the stock of specialty producer Green Mountain Coffee Roasters (GMCR). Its shares have boiled from 30 in May to 39 on Nov. 22. The big reason: GMCR's focus on organic coffee for consumers eager for chemical-free food has paid off. On Oct.27, McDonald's signed a pact for GMCR to supply (Paul) Newman's Own Organic coffee to 650 Mickey D eateries in the Northeast (page 16). On that day, GMCR's stock popped from 36 to 42. The stock is still a buy and should hit 52 in a year, says Joseph Phillips of Redwood Technimentals Research, thanks to its solid prospects for long-term growth and increased margins.

STRONGER AND HOTTER



GMCR produces more than 100 varieties of coffee and sells to supermarkets, convenience stores, and food-service and office distributors. It also sells by mail and online—its smallest but fastest-growing market. In its recent quarter, direct consumer sales jumped by more than 60% in dollar terms and 70% in pounds shipped. Scott Van Winkle of investment firm Adams Harkness tags its client GMCR a "buy" and calls the McDonald's deal "a huge win." Although he expects the setup will pull in just $5 million to $10 million in 2006, it could ultimately become a "much larger opportunity beyond the 650 restaurants," says Van Winkle. He expects GMCR to earn $1.18 a share on sales of $172 million in calendar 2005 and $1.33 on $212 million in 2006, up from $1.01 on $144 million in 2004.

Bustling Malls Pay Off For Federal Realty

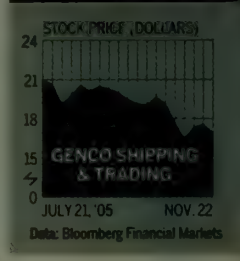
WITH FEARS ESCALATING THAT the housing party is over, investors are bailing out of real estate plays. But Lisa Kaufman, managing director at LaSalle Investment Management, remains upbeat on Federal Realty Investment Trust (FRT), which develops, manages, and owns shopping centers on the East and West Coasts. Federal's stock, of which LaSalle owns 3.5%, has been rising in spite of the plunge in other housing stocks and most REITs. Federal's stock raced from 55 in mid-May to 65 on Nov. 22. Kaufman says its properties have the highest-quality values in its peer group. They are in such places as Santa Monica and San Jose, Calif., and the fast-growing, high-density, upper-income Virginia suburbs of Washington. Philip Martin of investment outfit Stifel Nicolaus expects Federal to earn $3.04 a share in 2005 and $3.31 in 2006, up from 2004's $2.85. Martin calls Federal a "best-in-class REIT" that deserves a "premium valuation." He sees it at 72 in a year.

IN THE RIGHT SPOTS

Genco Ships Are Steaming Ahead

NOT MANY INVESTORS HAVE dry bulk tankers in their sights, but they offer wide-open opportunities, argues Magnus Fyhr of investment bank Jefferies Group. He rates Genco Shipping & Trading (GSTL) a buy—calling it a pure play in shipping steel, coal, and grain. Genco, which Jefferies and Morgan Stanley took public on July 5 at 21, is now at 17. The stock has become a better bargain, says Fyhr, as shipping volume has been growing rapidly. And charter rates have doubled since early August, he notes. The reason: the industrial boom in Asia. Chinese steel output in 2005 jumped 25%, to some 345 million tons, figures Fyhr. And Chinese iron ore imports this year are up 32%. Japan is also in the action, he says, with its imports from Brazil up more than 20%. Also increasing are coal imports to India. Fyhr has a 12-month stock price target for Genco of 28, based on his 2005 earnings forecast of $3.18 a share on sales of $95.1 million, and $3 (caused by an increase in the number of shares since its IPO) on sales of $106 million for 2006. Sumit Mathai of Kayne Anderson Capital Advisors, which owns shares, likes Genco's growth strategy of buying ships by using debt and and paying it down from free-cash flow. Genco's debt, says Mathai, is well below the average of its peers.

A SLIDE SINCE THE IPO



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

DATABASE

Most identity thieves don't gather their data from a computer.

Even in the age of the Internet, the majority of identity theft still takes place in low-tech ways—from stealing purses and wallets, to sifting through garbage for discarded statements and receipts.

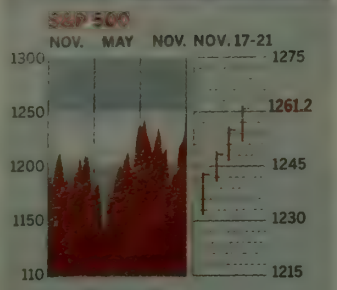
Identity theft hurts the victim. And it hurts Your Credit Card Companies. So we're fighting back—both on the Internet and off—with a wide range of proactive technologies and programs. For instance, every credit card application is verified by checking its information with one or more of the national credit bureaus. If a fraud or victim alert has been posted, the applicant is contacted directly. To learn more about what we're doing—and what you can do—go to our Web site, **www.YourCreditCardCompanies.com.**

Your Credit Card Companies citi MasterCard mbna DISCOVER CARD CHASE

A group of financial services companies that have joined together to help you understand consumer credit.

Personal Business Figures of the Week

STOCKS



COMMENTARY

Investors got a jump on Christmas shopping on Nov. 22, when the minutes of the last Fed Open Market Committee showed fed fund rate hikes may be coming to an end. Stocks rose on the news and the S&P 500 index and NASDAQ hit new highs for 2005. Helping lead the way were Boeing, Apple, and Goldman Sachs, which all reached new highs for the year.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	NOV. 22	WEEK % CHANGE	YEAR TO DATE % CHANGE	LAST 12 MONTHS % CHANGE
S&P 500	1261.2	2.4	4.1	7.1
Dow Jones Industrials	10,871.4	1.8	0.8	3.6
NASDAQ Composite	2253.6	3.0	3.5	8.1
S&P MidCap 400	739.8	3.2	11.5	17.1
S&P SmallCap 600	356.7	4.0	8.5	12.8
DJ Wilshire 5000	12,609.5	2.7	5.5	9.3
SECTORS				
BusinessWeek 50*	760.4	2.2	7.9	10.6
BW Info Tech 100**	381.0	2.2	2.1	6.2
S&P/BARRA Growth	603.9	2.1	3.8	6.4
S&P/BARRA Value	653.0	2.7	4.4	7.9
S&P Energy	382.5	4.1	32.5	31.3
S&P Financials	430.8	2.9	4.8	9.0
S&P REIT	155.6	3.6	7.7	14.5
S&P Transportation	249.8	5.1	3.4	6.9
S&P Utilities	158.2	1.8	11.7	12.8
GSTI Internet	211.7	5.3	18.7	34.5
PSE Technology	844.8	1.9	8.4	12.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	NOV. 22	WEEK % CHANGE	YEAR TO DATE % CHANGE	LAST 12 MONTHS % CHANGE
S&P Euro Plus (U.S. Dollar)	1447.3	2.3	3.6	10.7
London (FT-SE 100)	5517.2	1.6	14.6	16.6
Paris (CAC 40)	4580.8	1.5	19.9	21.4
Frankfurt (DAX)	5174.7	1.8	21.6	25.5
Tokyo (NIKKEI 225)	14,708.3	3.8	28.0	35.6
Hong Kong (Hang Seng)	14,885.7	1.6	4.6	7.9
Toronto (S&P/TSX Composite)	10,892.8	1.5	17.8	21.1
Mexico City (IPC)	16,866.8	3.4	30.6	42.0

FUNDAMENTALS	NOV. 21	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.81%	2.05%	1.95%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.4	18.0	19.9
S&P 500 P/E Ratio (Next 12 mos.)*	15.0	14.7	16.5
First Call Earnings Revision*	-2.08%	-1.91%	-0.17%

*First Call Corp.

TECHNICAL INDICATORS	NOV. 21	WEEK AGO	READING
S&P 500 200-day average	1202.8	1201.8	Positive
Stocks above 200-day average	60.0%	54.0%	Neutral
Options: Put/call ratio	0.67	0.65	Neutral
Insiders: Vickers NYSE Sell/buy ratio	2.90	2.71	Negative

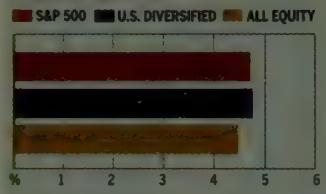
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Fertilizers & Ag. Chems.	25.0	Oil & Gas Refining	81.5
Paper Products	23.3	Fertilizers & Ag. Chems.	64.9
Constr. & Engineering	22.0	Managed Health Care	57.4
Home Furnishings	20.9	Constr. & Engineering	53.9
Tires & Rubber	20.9	Oil & Gas Exploration	53.6

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Automobiles	-8.5	IT Consulting	-50.7
Divsfd. Commercial Svcs.	-4.9	Automobiles	-40.6
Commerical Printing	-2.5	Photographic Products	-32.5
Packaged Foods	-2.0	Auto Parts & Equip.	-23.7
Photographic Products	-0.6	Home Furnishings	-21.4

MUTUAL FUNDS

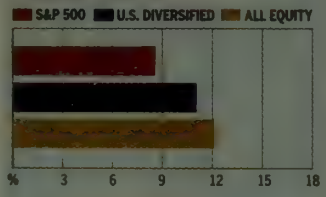
4-WEEK TOTAL RETURN

WEEK ENDED NOV. 21



52-WEEK TOTAL RETURN

WEEK ENDED NOV. 21



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	12.7	Latin America	68.1
Latin America	9.5	Natural Resources	36.9
Japan	8.5	Diversified Emerg. Mkts.	33.9
Diversified Emerg. Mkts.	6.9	Japan	26.5
LAGGARDS		**LAGGARDS**	
Utilities	1.0	Domestic Hybrid	6.5
Domestic Hybrid	2.6	Miscellaneous	7.6
Europe	2.7	Large-cap Blend	8.6
International Hybrid	2.7	Large-cap Value	9.5

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Ultra Japan Inv.	24.3	ProFunds Ultra Japan Inv.	80.8
Fidelity Select Gold	19.5	T. Rowe Price Lat. Am.	74.8
Merrill Lynch Glbl. Val. B	16.9	iShares S&P L. Am. 40 Idx.	73.2
ProFunds Biotech. Inv.	16.1	Merrill Lynch Lat. Am. C	69.5
LAGGARDS		**LAGGARDS**	
American Heritage Grth.	-20.0	Ameritor Investment	-60.9
American Heritage	-11.1	American Heritage Grth.	-42.9
Rydex Dyn. Vent. 100 H	-10.8	American Heritage	-27.3
ProFunds UltSh. OTC Inv.	-10.8	ProFds. USh. Mid Cap Inv.	-26.7

INTEREST RATES

KEY RATES	NOV. 22	WEEK AGO	YEAR AGO
Money Market Funds	3.56%	3.51%	1.46%
90-Day Treasury Bills	3.92	4.00	2.16
2-Year Treasury Notes	4.30	4.40	2.95
10-Year Treasury Notes	4.43	4.47	4.18
30-Year Treasury Bonds	4.66	4.66	4.84
30-Year Fixed Mortgage †	6.33	6.33	5.75

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.94%	4.48%
Taxable Equivalent	5.63	6.40
Insured Revenue Bonds	4.02	4.57
Taxable Equivalent	5.74	6.53

THE WEEK AHEAD

DURABLE GOODS ORDERS *Tuesday, Nov. 29, 8:30 a.m. EST* » October durable goods orders most likely rose 1.5%, after a 2.4% fall in September. That's the median estimate of economists polled by Action Economics.

CONSUMER CONFIDENCE *Tuesday, Nov. 29, 10 a.m. EST* » The Conference Board's November consumer confidence index probably rebounded to 89.3, after easing to 85 in October.

GROSS DOMESTIC PRODUCT (REVISED) *Wednesday, Nov. 30, 8:30 a.m. EST* » Revised figures for third-quarter real gross domestic product are expected to show an annual growth rate of 4%, after an initial estimate of 3.8%.

PERSONAL INCOME *Thursday, Dec. 1, 8:30 a.m. EST* » In October income likely grew 0.5%, after a 1.7% surge. Consumer spending probably rose 0.2%, after a September gain of 0.5%.

PURCHASING MANAGERS' INDEX *Thursday, Dec. 1, 10 a.m. EST* » The Institute for Supply Management's November factory activity index probably eased to 57.5%, from 59.1% for October.

EMPLOYMENT *Friday, Dec. 2, 8:30 a.m. EST* » Nonfarm payrolls are forecast to have grown by 200,000 during November, following a rebound of 56,000 in October. The jobless rate very likely held steady at 5%.

The *BusinessWeek* production index rose to 261.8 for the week ended Nov. 12 and stood 13.3% above the previous year's reading. Before calculation of the four-week moving average, the index declined to 262.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

The McGraw-Hill Companies

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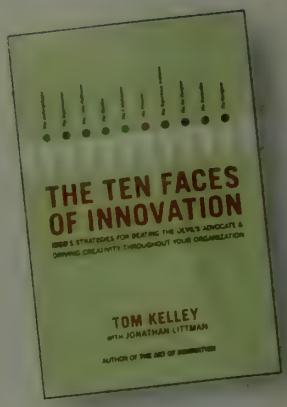

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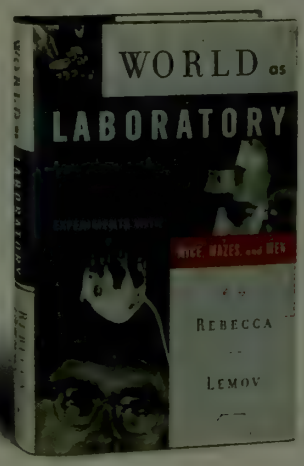
Men in White

WORLD AS LABORATORY Experiments with Mice, Mazes, and Men
By Rebecca Lemov; Hill and Wang; 291pp; $30.00

In 1916, scientist John B. Watson created an outcry by performing psychological experiments on babies. In one test at the Phipps Clinic in Baltimore, he trained an infant nicknamed Little Albert to fear white rabbits. Each time the tot reached out in delight to touch a bunny that Watson brought into the lab, Watson bashed a claw hammer against a steel rod to make a startling noise. Soon, Watson claimed, Albert recoiled in terror every time he saw the rabbit—or any white, furry object for that matter—even when there was no ear-splitting clang accompanying it. Watson's conclusion: Fear, not love, is the most powerful tool for conditioning a person's social and emotional life.



Watson was one of the pioneers of human engineering—an often shocking branch of psychology that first-time author Rebecca Lemov examines with gusto in *World as Laboratory: Experiments with Mice, Mazes, and Men.* As Lemov walks readers through this history, she describes the close relationship between human-behavior researchers and Big Business. Watson, for example, went on to become a top executive at advertising giant J. Walter Thompson. There, Lemov reports, he helped pioneer the technique of selling products based on their emotional appeal rather than actual attributes.

Lemov, who has taught history and anthropology at the University of Washington, has produced a work that reflects her exhaustive research, yet is strangely incomplete. The ever greater understanding of human behavior has had a wide impact, she says, on everything from military training techniques to industry, notably in advertising, focus groups, and consumer surveys. Business readers, however, may be disappointed that she doesn't devote more attention to these commercial uses.

While less than comprehensive, the business-related episodes are some of the most memorable. This includes the 1920s and '30s experiments in "scientific management" of factory workers, carried out at the Hawthorne Works factory of the Western Electric Co. in Chicago. The study was managed by Elton Mayo, a Harvard University psychologist, and funded by John D. Rockefeller Jr. In one phase of the research, Mayo interviewed 20,000 disaffected young workers who performed tasks that were both repetitive and exhausting. Mayo was surprised to discover that the simple act of interviewing the employees boosted their morale. He concluded that infusing workers with a sense of belonging endears them to the company and ultimately benefits the entire industrial process.

How "science" sought to modify human behavior

Where Lemov shines most brightly is in her colorful descriptions of the scientists who pioneered the study of human behavior. Anyone who took college Psych 101 likely remembers Stanley J. Milgram and his famous 1961 experiment at Yale University, during which he persuaded volunteers to administer what appeared to be

creasingly painful electric shocks to her test subjects. (The shocks and sulting screams, unbeknownst to rticipants, were staged.) The research mously showed just how easy it is to rn ordinary people into torturers. ilgram was also an artist who wrote rettos in his free time and played actical jokes on his friends. A natural m, Milgram captured his studies on m. In one scene, a reluctant study rticipant is told: "The experiment quires you to continue." The grainy ack-and-white footage is still shown in llege classrooms today.

Many other famous scientists put in pearances, including Harvard searcher-turned-LSD advocate mothy Leary. His lab at Harvard is ten credited with laying the oundwork for the modern focus oup. Leary colleague Robert F. Bales vised "the architecture of one-way mirrors, adjoining observation rooms, and recording devices," Lemov explains. Again, though, the author doesn't give us enough on the real workplace example; aside from the brief Bales mention, she says little about how social engineering has influenced the design of the focus groups that some companies still rely on to make crucial product and marketing decisions.

Lemov also fails to fully describe psychology's impact on the one industry that has mastered the art of manipulating human behavior: advertising. She declares early in the book that behavior-modification theories examined by Watson and others formed the basis of "every advertising technique." I wish she had followed through with rich examples that would bring the relationship between the two disciplines to life. ■

–By Arlene Weintraub

The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS

1. **THE WORLD IS FLAT** Thomas L. Friedman (Farrar, Straus & Giroux • $27.50) *Globalization is great—sort of.*
2. **FREAKONOMICS** Steven D. Levitt, Stephen J. Dubner (Morrow • $25.95) *Crack gangs, the Ku Klux Klan, and more.*
3. **BLINK** Malcolm Gladwell (Little, Brown • $25.95) *Why snap judgments deserve careful consideration.*
4. **THE MARTHA RULES** Martha Stewart (Rodale • $24.95) *A handbook for business success.*
5. **SECRETS OF THE MILLIONAIRE MIND** T. Harv Eker (HarperBusiness • $19.95) *How to shape your financial destiny.*
6. **WINNING** Jack Welch with Suzy Welch (HarperBusiness • $27.95) *How to succeed within a company and against the competition.*
7. **JIM CRAMER'S REAL MONEY** James J. Cramer (Simon & Schuster • $26) *The CNBC commentator's trading tips.*
8. **THE LITTLE RED BOOK OF SELLING** Jeffrey Gitomer (Bard Press • $19.95) *A syndicated columnist explains why people buy.*
9. **BAIT AND SWITCH** Barbara Ehrenreich (Metropolitan • $24) *A reporter goes undercover and joins the white-collar jobless.*
10. **COLLAPSE** Jared Diamond (Viking • $29.95) *Why civilizations fall apart.*

PAPERBACK BUSINESS BOOKS

1. **GETTING THINGS DONE** David Allen (Penguin • $15) *Organize your life.*
2. **RICH DAD'S BEFORE YOU QUIT YOUR JOB** Robert T. Kiyosaki, Sharon L. Lechter, CPA (Warner • $16.95) *Starting a business.*
3. **THE 48 LAWS OF POWER** Robert Greene (Penguin • $17) *Rules for strivers.*
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6. **THE MILLIONAIRE REAL ESTATE INVESTOR** Gary Keller, D. Jenks, J. Papasan (McGraw-Hill • $21.95) *Empire-building.*
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8. **WHAT COLOR IS YOUR PARACHUTE?** Richard Nelson Bolles (Ten Speed • $17.95) *The 2005 edition of the enduring job-search bible.*
9. **HOW TO WIN FRIENDS AND INFLUENCE PEOPLE** Dale Carnegie (Simon & Schuster • $14) *The classic networking guidebook.*
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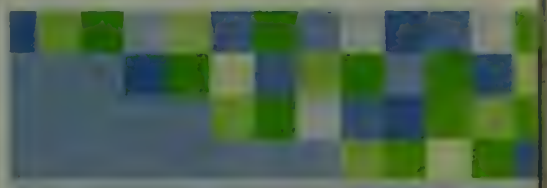

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WITH MARIA BARTIROMO

Carlos Ghosn on Detroit's Odds

WITH THE DRAMATIC NEWS about plant closings at General Motors and more job cuts at both GM and Ford, one name keeps popping up as the man to help Detroit make a sharp U turn—Carlos Ghosn, chief executive of Nissan and Renault. A former Detroit chieftain told me: "There are real structural problems at GM, and it's beyond one person. It's one thing to close plants down, but you're still paying those workers." Ghosn is more circumspect. When I recently spent time with him in New York, he was guarded about telling GM or Ford how to fix their businesses. And when I asked about Bill Ford reportedly twice offering him the No. 2 job at Ford Motor, he declined to comment. He did, however, handicap the odds of his Motor City rivals pulling off a turnaround like the one he engineered at Nissan.

What chance do Ford and GM have to be considered winners again?
For any viable [turnaround], the chances are 50%. I gave myself 50% when I came to Japan.... I think any auto maker has [a chance], particularly when you have a great name and you have a lot of people around the world. I am not as pessimistic about [the industry as others are].

The last time we spoke you said business was tough in September and the beginning of October. How are things going today?
We are seeing a big shift from big cars to smaller cars. We are also seeing people shift to smaller engines. I would be bearish in 2006. I am talking about the industry and the environment. Nissan is doing well, but the environment is going to be much more difficult.

Why have things been so tough?
Probably what you are seeing is that people who like larger cars, pickup trucks, luxury sedans, and SUVs are waiting to see where energy prices will be. People who want to buy fuel-efficient cars...will continue to do so. But people who are attracted to bigger engines are waitin

The price of oil has finally begun to push consumers to look fo fuel-efficient cars. How significant is this change?
We are going to have the arrival on the market not only of mo fuel-efficient engines but also more environmentally frien engines. We can't produce enough Altimas and Sentras, [whi is] the smallest car in the lineup.

Is there any economic vibrancy in Europe right now?
The market is mainly stagnant, and it is stagnant for one re son: It is a mixture of countries, each one in a different pha You have Eastern Europe, which is extremely vibrant. There investment and competition...overall, it's going in the right rection. But then you have Western Europe, which is goi through adjustments as it tries to combine with the rest of t world. So normally when you have countries looking for dire tion, you have some stagnation. I am cautious for the near ter

What about China? Is that the market that wi make or break companies like yours in the 21st century?
Nissan continues to invest heavily in Chin Thailand...we want to grow in India. We a starting to build a plant in the Mideast. W are particularly focused on Asia. Renault not going where Nissan is, but [they will tr to complement [each other]. You can imagi the following scenario, where Renault w take advantage of Nissan's presence in Chi and in Southeast Asia...and Nissan w leverage Renault's presence in India.

Tell me more about Asia.
That is where the action will take place. Yo have Japan coming back, and I knew it w happening. [But] I was the only one saying The Japanese have been working very hard. Japan will still be the second-largest econom and competing at a high level for a long tim China and India are also waking up and doi the right things. You have Southea Asia...Malaysia, Singapore, and many oth countries trying to come back on the ec nomic scene. The next 10 years will be t Asian years.

Maria Bartiromo is the host of CNBC's Closing Bell.

SNAPSHOT

THE WHEELS OF A CAR GUY
I drive many cars. My personal car in Tokyo when I just want to enjoy driving is a convertible [Nissan] Z. When it comes to the company car, what I am driven in is the [Infiniti] Q45. In France my official vehicle is the Vel Satis, Renault's flagship car. The Modus, a small city car, is very convenient in Paris. In the U.S. [I ride around in] the QX56.

AN UNCANNY KNACK FOR FINDING GROWTH

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Alger SmallCap Growth Fund (A) 01.01.97 (SMALL-CAP GROWTH FUNDS)	1st (4/522)	1st (58/436)	3rd (223/327)	4th (454/546)

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Source: Lipper, a Reuters Company, for the period ended 9/30/05. Lipper is a nationally recognized organization that ranks the performance of mutual funds within a universe of funds that have similar investment objectives. Rankings are historical and are based on total return with capital gains and dividends reinvested. Rankings do not consider sales charges. Lipper ranking is for the A share class only; other classes may have different performance characteristics.

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Investing in Dynamic Change

ALGER

A Smart Move For Fair Trade

OCCASIONALLY IN Washington, though far too infrequently, common sense manages to best politics. That happened on Nov. 18, when the U.S. House of Representatives voted to repeal the five-year-old Continued Dumping & Subsidy Offset Act (CDSOA), the so-called Byrd Amendment that mandates that financial penalties from trade "dumping" cases be paid directly to the companies that filed or supported the initial complaint rather than to the Treasury.

We certainly don't disagree with the argument that dumping—which occurs when foreign manufacturers sell goods for less here than they do in their home markets—is disruptive to global trade. But the Byrd Amendment thumbs its nose at years of international rulemaking while effectively subsidizing companies that know how to game the law. The World Trade Organization agrees: It has ruled several times against the legality of the Byrd Amendment and has allowed additional tariffs of up to $134 million to be assessed against the U.S. because of its refusal to repeal or modify the CDSOA.

Even opponents of the WTO should be able to recognize that the CDSOA, tacked onto a crucial spending bill in 2000 without debate, is bad law. Its filing restrictions favor complainants who get to the courthouse first. Other businesses don't share in any payout even if they're the ones most affected by the dumping behavior. The result: a virtual government subsidy that encourages speedy filing of complaints that are often never systematically verified by the government, with penalties unevenly distributed across affected industries.

The Senate should follow the House's lead in ditching an unjust dumping law

A recent study by the U.S. Government Accountability Office found that about half of the $1 billion in penalties collected since the CDSOA's adoption have gone to just five companies. And about two-thirds of total payments have ended up in just three industries: steel, bearings, and candles. If this sounds like an unseemly way for politicians to funnel cash to a favored few constituencies, it is.

Worse, the GAO found that some U.S. companies affected by dumping that did not share in the payouts were put at a disadvantage when they later had to compete against companies whose coffers were fattened by Byrd Amendment cash. (So much for using trade laws to level the playing field.)

Most damning, however, is that the Byrd Amendment tarnishes the reputation of the U.S.—long a tireless promoter of a rules-based trading environment—as a defender of global transparency and the rule of law. Congress' past refusal to accept the WTO decision against the CDSOA, along with its foot-dragging in settling a similar $5 billion Canadian judgment against the U.S. in a lumber dispute under the North American Free Trade Agreement (NAFTA), have given America's critics the understandable impression that the U.S. supports trade rules only when they favor its interests.

Besides violating established trade pacts, such behavior is amazingly shortsighted. Trade fuels global growth while easing security tensions for everyone—especially for the increasingly trade-dependent U.S. That's why last week's House vote was a prudent move, and the Senate should take similar action when it returns in December. America cannot afford to cede the moral high ground on trade.

AIDS: Education Cuts the Toll

MUCH INK HAS BEEN spilled lately about the uncertain prospect of a worldwide bird flu pandemic that could endanger the lives of millions worldwide. But on Nov. 21 the U.N. and the World Health Organization highlighted the terrible certainty of human suffering and death that AIDS holds for much of the developing world when they released their annual report on that very real global epidemic.

The report estimates there were about 5 million new HIV infections in 2005—64% of them occurring in sub-Saharan Africa, the world's most affected region. That brings the number of people living with HIV worldwide to an estimated 40.3 million. But at least they are living with the scourge: More than 3 million people will die of AIDS-related illnesses in 2005. At least a half-million of the dead will be children.

It's difficult to call the latest report encouraging, but there is some promising news: Kenya and Zimbabwe showed solid declines in infection rates. And Caribbean nations such as the Dominican Republic and Haiti showed a drop in infection rates for pregnant women as well as signs of increased condom use and voluntary testing for HIV status.

Positive stories like these suggest that the worldwide push to raise awareness is having an impact on transmission. Why is public education so important? Because there is not enough affordable medicine to effectively treat the afflicted outside the richest nations. There are only about 1 million HIV patients receiving AIDS drugs in the developing world, and it's likely that upwards of 250,000 lives were saved last year thanks to such therapy. But it's small change given the need.

More comprehensive education about how not to contract or transmit the disease means ultimately there will be fewer people who require costly care. Indeed, in this epidemic, with so many victims residing in poor nations with limited treatment resources, prevention is still the best medicine.

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The MySpace Generation

They live online.
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How companies are reaching them
(P.86)

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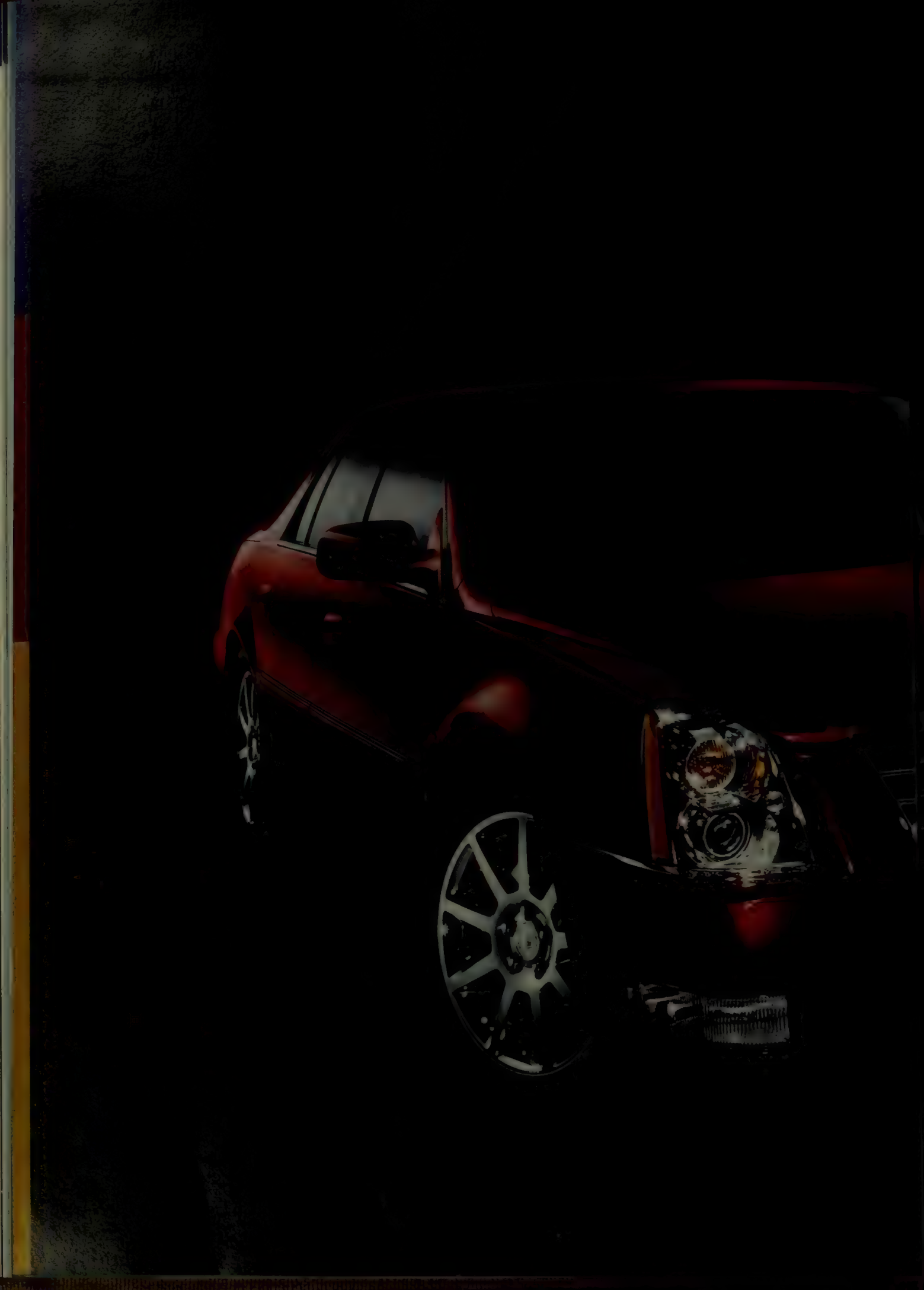

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BusinessWeek

December 12, 2005

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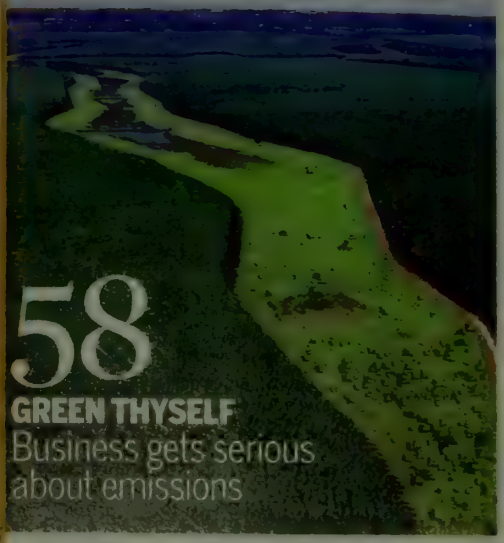
More and more young people live online. Will they let business in?



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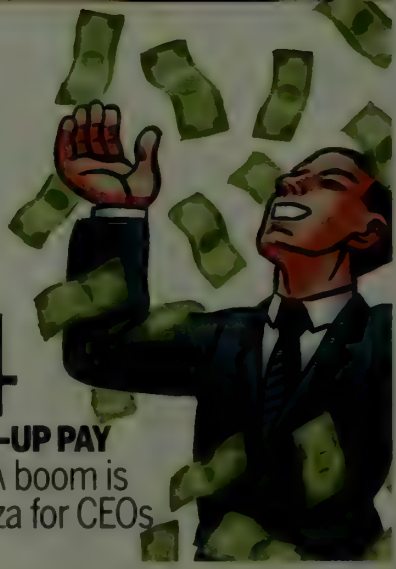

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You've probably never heard the term

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New York Life

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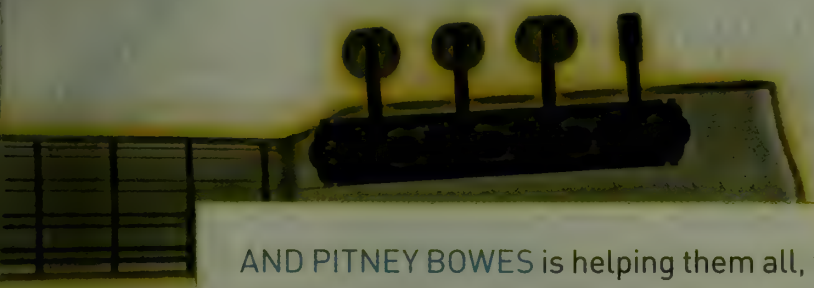
but you've definitely heard of the companies that are using it to grow their bottom line.



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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Hendrick's $30/750ml	Most Flavorful
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The Best Entrepreneurs Under 25—As Picked By Our Readers

With so many new businesses led by younger entrepreneurs, we recently asked readers to help us find the next generation of success stories. The results are in. First, we winnowed the 100 nominees to 20 finalists, and based on reader voting we now have the **top five.** Among them is **Joanna Alberti,** who started philoSophie's, a greeting-card company aimed at inspiring courage in women. All five winners are featured in a **slide show** on our SmallBusiness channel. Stop by and get to know them better

Value Stocks Are Getting A Whole New Look

Well-known large caps like Wal-Mart and Microsoft—yesterday's growth outfits—are now generating buzz as value plays. This analysis from Standard & Poor's explains why

VoIP Providers: Are They Heeding the Call?

Internet phone services are catching on, yet quality is still suspect. With an industry shakeout likely, this story explains, the pressure is on to fix the problems

Public Enemy Stakes Its Claim In the New Wireless Order

The legendary hip-hop group sees wireless distribution as a new way to air its message. Here's a look at how the creators of *Fight the Power* hope to shake up the music industry—and make a little money

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UP Front

"Essentially, the judge is holding a gun to RIM's head to settle."

–Analyst Richard Williams, to Bloomberg, on a judge's ruling against BlackBerry maker Research In Motion (page 32)

DITED BY DAN BEUCKE

CO WATCH

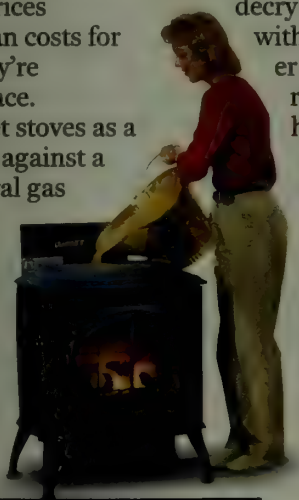
AND NOW, THE HIGH COST OF PELLETS

OUSEHOLDERS, SHOCKED by eating costs, are flocking to n alternative source: wood-ellet stoves. But as stove emand surges, the condensed awdust pellets that serve as uel are getting hard to find. hat has pellet prices oaring faster than costs for e fossil fuel they're upposed to replace.

Many see pellet stoves as a ay to fight back against a 0% rise in natural gas rices. Pellets, ecycled from umber, burn leaner than aditional ood stoves and heaper than as or oil. **Home epot** says it has sold more pellet stoves in the past two months than in all of last year. But that has created a run on pellets. As a result, some stores are restricting sales: **The Best Fireplace Co.** in Oak Creek, Wis., sells pellets only with a stove purchase. Pellet hunters complain of paying $6.75 per 40-pound bag in Massachusetts and $8 on Long Island, N.Y.—twice the usual price.

Posts on **TreeHugger.com** decry the pellet scarcity, with one irate customer threatening to return his stove if he couldn't find some soon. "Mills are running 24/7" to catch up with demand, says Don Kaiser, executive director of the Pellet Fuels Institute. Until then, you know the drill: Get in line.

–Coleman Cowan



RETAIL DETAIL

Making the Most Of Cyber Monday

TRADITIONAL RETAILERS have their Black Friday, the day after Thanksgiving, when shoppers hit the malls in droves. Now online retailers have Cyber Monday, when people return to work to shop online courtesy of their company's high-speed connection. Or so the story goes. But it turns out Cyber Monday isn't so special after all. The first big spike in online shopping traffic comes days before Thanksgiving. And the post-holiday Monday actually ranks only about 12th on the list of biggest days of the online season.

So what's up with Cyber Monday? Credit savvy marketing by the online retail association **Shop.org,** which coined the term in a Nov. 21 press release. It's not entirely a myth: Some retailers do see a traffic spike on the Monday following Thanksgiving. But the hype may be helping. Monday sales at Web jeweler Ice.com jumped 92% above last year's level—thanks in part to a sold-out sale it headlined "Cyber Monday Blowout."

–Rob Hof

THE BIG PICTURE

DISCOUNT DAYS With General Motors stock trading near a 14-year low, here's a sobering look at some companies that now boast a larger market cap.

UP Front

FUND WATCH

CLEARING THE DECKS AT CLIPPER

THOSE PROBES and reforms pushed by New York Attorney General Eliot Spitzer and the **Securities & Exchange Commission** finally may be having an effect on mutual

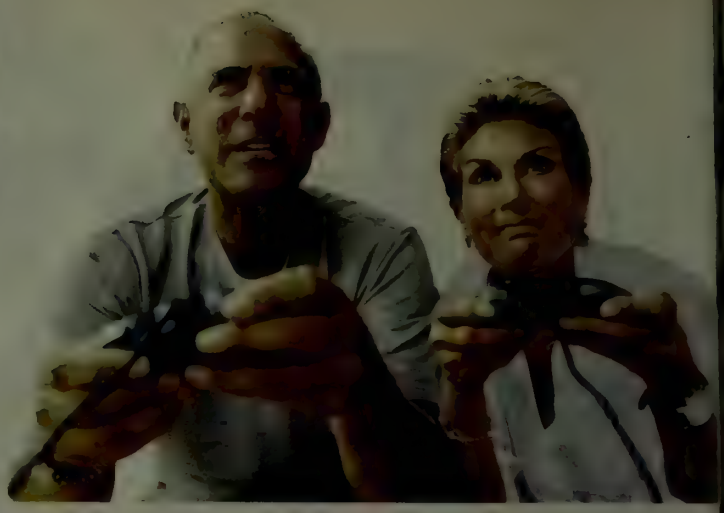
funds. Their boards are supposed to represent fund shareholders, not management companies. But in almost every case over the past 65 years, boards have stuck with current management when it came time to review contracts. Critics grumble that when one set of managers leaves, the job—and its rich fee stream—is passed along to another set at the same firm.

So when independent directors of the $7 billion **Clipper Fund** said in October they were looking for a new manager, the fund world yawned. **Old Mutual,** owner of the value fund's manager, even said it had a successor lined up. But the industry snapped to attention on Nov. 30, when the Clipper board said it was dumping Old Mutual's **Pacific Financial Research** in favor of a highly regarded outsider, **Davis Selected Advisers LP**.

The process was set in motion when Clipper founder James Gipson announced that his team would leave Pacific at year end. Gipson's performance was stellar for much of the past 10 years, beating 98% of similar funds, according to **Morningstar.** But recently it stumbled; the fund is down 1% in 2005, trailing its group average by almost 9 points.

Michael Glazer, a lawyer representing Clipper directors, says the biggest factor in choosing new managers Christopher Davis and Kenneth Feinberg was that their style at the **Davis New York Venture Fund** was similar to Gipson's—focusing on a few undervalued stocks. But the Davis fund has gained nearly 11% this year. For Clipper shareholders, it also helps that Davis and Feinberg plan to lower investment advisory fees and waive management fees in excess of 0.5%.

–Aaron Pressman



GROWN-UPS' TURN

GAMER BOYS, SHOVE OVER. There's a new pro player in town, and it might be your mom. Next summer, "casual gaming" site SkillJam.com will offer $1 million to the best player in video games such as solitaire, Bejeweled 2 (line up colored cubes to win points), and Zuma (zap balls out of a frog's mouth). These are favored by older players, such as soccer moms hiding out in the den. SkillJam President Paul Jensen says 13 players (including some guys) have qualified so far in tournaments costing as little as $2.50 to enter. The action may not be as intense as the shooter-dominated Cyberathlete Professional League. Still, $1 million could buy one sweet minivan. *–Ronald Grove*

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UPFront

HEADLINER

RICHARD CLARK

THE RIGHT MEDICINE FOR MERCK?

Richard Clark, Merck & Co.'s new chief executive, has made his first move—and Wall Street isn't impressed. Clark, 59, announced on Nov. 28 the first phase of what he calls a global restructuring that will cut 7,000 jobs—11% of the drugmaker's workforce—and five factories. The overhaul aims to save $4 billion through 2010. But Merck's stock fell 4.6%, to 29.56, on the news—capping a 66% fall over the past five years.

The lack of enthusiasm isn't hard to fathom. For one thing, $4 billion was less than what many analysts expected. And Clark, who ran manufacturing at Merck before replacing CEO Raymond Gilmartin last May, has yet to show he has a fix for a weak product pipeline and the likely multibillion-dollar liability from lawsuits Merck faces over its withdrawn painkiller, Vioxx. True, rivals like Pfizer also are struggling to generate growth. But investors will be watching Clark's Dec. 15 analyst presentation to see if he has any more answers. *–Amy Barrett*

STREET NEWS

HOOFY AND BOO HAVE HOT TIPS FOR YOU

MORE THAN 2,000 sophisticated investors get daily market commentary from a cartoon bull named Hoofy. He's one of several characters dreamed up by Todd Harrison, a former hedge-fund manager who in 2002 created the investor education Web site **Minyanville.com.** Boo the bear supplies healthy skepticism. In addition, Snapper the turtle appears during snapback rallies. Don't be fooled: Harrison enlisted seasoned investors to write for him, including hedge-fund manager John Succo and options specialist Jon "Dr. J." Najarian.

Even a cartoon bull or bear would have a tough time cutting through the post-boom skepticism of investors. "These guys have a tough row to hoe," says **Forrester Research** analyst Bill Doyle, citing struggles at other paid investing sites such as **TheStreet.com.**

Nevertheless, a redesigned Minyanville is set to appear by January, adding more accessible content in a bid for a broader audience. The site has drawn a cult following o unusually loyal readers. The recently presented Minyanville with an electric guitar signed by Warren Buffett, George Soros, Bill Gross, an other investing legends. It will be auctioned off for charity during the period Dec. 7-16. *–Justin Hibba*

ZEN AND NOW

BUDDHA—THE CASE STUDY

IN CHINA these days, the Eightfold Path may have more to do with finding business acumen than enlightenment—at least that's the case for about a dozen Buddhist monks taking MBA classes this fall at **Shanghai Jiaotong University.**

Growing incomes in China have translated into larger donations to temples that survived the Cultural Revolution, requiring more financial expertise among their monks. That includes the century-old **Jade Buddha Temple,** one of the largest in Shanghai. It's run by 35-year-old Master Abbot Jue Xing, who sent his monks off to study temple management in a nondegree training course that includes studies of accounting, corporate strategy, religious-product marketing, and Sun Tzu's *Art of War*, according to Chen Changhui of the **Shanghai Jiaotong School of Management.** The abbot also presided over the temple's launch of a Web site and computerized its operations. *–Sheridan Prasso*

THE STAT

55

The percentage growth of spending on U.S. online advertising in the third quarter; traditional media grew only 2.2%, the slowest rate in eight quarters.

Data: Sanford C. Bernstein & Co.

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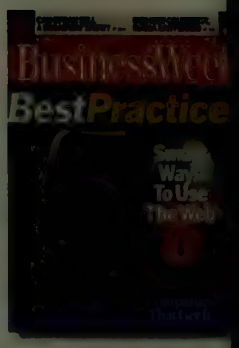
> "Applications such as [Safari and Firefox] disrupt the status quo and pose a . . . threat to the hegemony of Microsoft."
>
> *–Tony Wasserman*
> *San Francisco*



THE POWER OF OPEN-SOURCE SOFTWARE

MANY OF THE SITES highlighted in "The Web Smart 50" have been built on open-source software, freely available to one and all around the world (Special Report, Nov. 21). Furthermore, those sites are generally accessible from any Web browser on any platform. The standards-compliant Safari on Mac OS X and Firefox on numerous platforms often work better with these sites than does Microsoft Corp.'s Internet Explorer on Windows.

Applications such as these disrupt the status quo and pose a substantial business threat to the hegemony of Microsoft and enterprise software vendors.

–Tony Wasserman
San Francisco

HOW THE BOND MARKET SIZES UP THE ECONOMY

IN "INFLATION: SHOPPERS vs. the bond market" (Economics, Nov. 21), the statement, "What matters most is not what inflation was, but what people think it's going to be," is off base. Inflation is notoriously the worst of the lagging indicators, generally peaking well after the economy has peaked, and more importantly, well after bond yields have peaked.

More likely the bond market accurately smells the eventual negative impact of growth from the persistent Fed tightening and the past surge in oil. This is now being compounded by clear signs of cooling in the housing market as housing affordability is at its lowest level in more than a decade.

–Robert J. Paris
Jupiter, Fla.

CHINESE DESIGNERS: COPYCATS—OR WORSE?

AS FOR THE INCREASED emphasis designers are placing on developing products to market to mainland China, the question still looms as to when China will start to enforce copyrights and make a effort to thwart the rampant counterfeiting and reproduction ("China design," Global Business, Nov. 21).

It seems evident from your article that many large multinationals are willing to accept this risk to establish a presence in China. But as consumers' buying power continues to rise in China, they will demand more products and services that might not be available until the Chinese government takes action to protect

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rights. Hopefully we will see some change in policy (or development of some) in the near term to allow for more investment in China.

–Andrew Hoffarth
Wahpeton, N.D.

YOUR ARTICLE highlights Haier Group Co.'s design of locating the dishwasher controls on the top of the machine (vs. the front panel) as an element of convenience for the user. The cited designer, Shen Weibin, should offer credit to another manufacturer (KitchenAid) that introduced this identical feature two-plus years ago! This idea did not come from their think tank! U.S. companies should be concerned that the last bastion of competitiveness, design, may be open to the same treatment and enforcement of intellectual property rights.

–Michael Stefko Jr.
Dallas

THE HAIER DISHWASHER looks strikingly similar to the Bosch model that our family purchased three years ago. The Chinese have done a remarkable job as a manufacturer for the world, but they rely on copycat design, if not a complete disregard for intellectual property rights.

–Roger Ness
Arlington Heights, Ill.

UNCLE SAM: 230 AND BROKE

THE MANNER in which well-educated citizens, many of them MBAs, are handling their personal finances does not say much for their college education ("Thirty & Broke," Special Report, Nov. 14). These loans are less than their annual incomes and could be paid off within a few years of belt-tightening.

Matters are not very different in the U.S. government ("Spending is out of control," Outside Shot, Nov. 14). The author quotes George Washington about "not ungenerously throwing upon posterity the burden which we ourselves ought to bear." How will posterity bear the burden of a huge federal budget deficit when it is struggling with personal debt? And what will happen when the Thirty & Broke generation is running the finances of the U.S. government?

–Neeraj Matiyani
Bangalore

THE DUTCH WAY TO PLUG HOLES IN THE WEB

"INVASION of the stock hackers" (News: Analysis & Commentary, Nov. 14) highlights the danger created by many U.S. online banking and trading companies, where ease of use supersedes the security necessity. Living in the Netherlands, I often gripe about the security protocol necessary in order to use my local Internet banking and trading accounts. Requirements such as the use of a unique bank pass in combination with a random PIN generator for online banking, or the ability to transfer funds out of a trading account only to the account of the money origination, no longer seem to be tedious and overdone.

No system is fail-safe. Nevertheless, kudos to the Dutch system, where security protocols are not taken for granted and the skills and tenacity of the crooks are not underestimated.

–Walter Sun
Den Bosch, The Netherlands

FEDEX DRIVERS' ROLE IN LITIGATION

"THE GROUND WAR at FedEx" (News: Analysis & Commentary, Nov. 28) took on a complex legal matter. What it failed to acknowledge are 14,000 current owner-operators for FedEx Ground, 99.5% whom have nothing to do with the la suits. We believe your article misstated, missed altogether, some points very i portant to the overwhelming majority these independent contractors, as well to the company.

The primary issue here is the alleg "control" exerted on independent co tractors. The operating agreement th signed when they began their relatio ship with FedEx Ground includes ter that are driven by customer and regulat ry requirements. It is inaccurate to s "FedEx agrees it imposes some wo rules on drivers...." Three Fed Ground contractors conveyed that poi of view to *BusinessWeek* and directly co tradicted the plaintiff you interviewed the issue of mandated starting times a other alleged "rules."

Contrary to the views of plaintiffs' a torneys, the California superior court d cision you cited actually provides us wi the opportunity to continue operati with contractors throughout the stat making adjustments as necessary.

Three-quarters of the plaintiffs in th case no longer have a business relatio ship with the company. They—and the lawyers—now seek financial rewa through the courts, instead of throug the opportunity of business ownership FedEx Ground. We believe that t courts—as they have done in more tha 100 previous cases—will ultimately u hold an arrangement that allows owne operators to continue their successf businesses as FedEx Ground indepen ent contractors.

–Daniel J. Sulliva
President and CE
FedEx Groun
Moon Township, P

Editor's note: See correction box.

CORRECTIONS & CLARIFICATIONS

"The big picture" (Up Front, Dec. 5) incorrectly states that emerging-market international equity investments by U.S. pension funds, foundations, and other traditionally conservative investors rose to $1.035 trillion in 2004, or 16.2% of total investments. That should have referred to all international equity investment. The total for emerging markets alone was $93 billion, or 1.5% of the total.

In "Krispy Kreme has that glazed look" (News: Analysis & Commentary, Dec. 5), the decline in Krispy Kreme's store count was incorrect. The number of stores, including satellite locations, has declined since January from 440 to about 420.

"The ground war at FedEx" (News: Analysis & Commentary, Nov. 28) erred in stating that FedEx Ground division drivers asked for the consolidation of class actions pending in 23 states into a single case in an Indiana Federal Court. It was FedEx that requested the consolidation.

The table accompanying "Cars that brake when you don't" (Global Business, Nov. 14) should have clarified that Honda's air bag for motorcycles takes just 0.15 seconds after a collision to absorb the force of the rider. The air bag inflates in 0.06 seconds.

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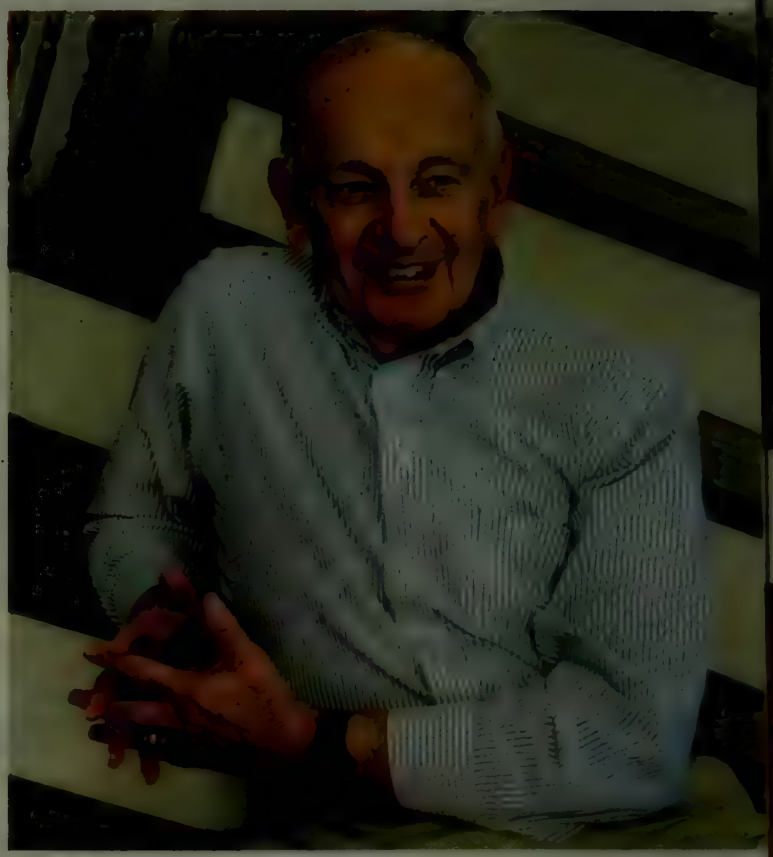

WHILE STUDYING FOR his 1962 PhD in electronics from Princeton University, George H. Heilmeier worked part time at RCA Corp.'s David Sarnoff Research Center, better known as RCA Laboratories. There, Heilmeier was exploring solid-state microwave devices—early forerunners of the chips in today's cellular phones and radars. But the friend with whom he commuted to RCA Labs kept telling him about research on novel devices called organic semiconductors. Soon, Heilmeier itched to switch.

His boss helped put Heilmeier on a path that made him an icon of U.S. innovation in both civilian and military circles. "He told me: 'Look, there are very few times in your career when you can do something completely different [and] have a chance to break new ground.' So I decided to do my thesis on that." His dissertation on organic semiconductors led to a half-dozen scientific papers—and then to a breakthrough discovery at RCA Labs: the first key to a practical liquid-crystal display (LCD). That was in 1964. Heilmeier was 28.

Wary of rivals, RCA immediately blanketed the project in secrecy. In 1968, Heilmeier's handiwork was finally unveiled with much fanfare about LCDs being the future of TV sets. But the pioneer of color-TV tubes turned stingy at funding further LCD development. In Japan, computer and TV makers had the opposite reaction: They pounced on the technology and invested in long-term development. Today, Japanese companies and newer rivals in Korea and Taiwan dominate the $39 billion LCD business.

RCA's dropping the ball "was a shame," says Heilmeier, now 69. "But our wounds were self-inflicted." Like Xerox Corp., which failed to exploit some of its key inventions at Xerox PARC, RCA may have been blinded by its earlier triumph in color TV. "Once you have a success of that magnitude," he says, "it's difficult to convince people that [a new technology] could be the long-term future."

Frustrated, Heilmeier left RCA in 1970, never to return to LCD research. But he did go to Japan in mid-November of this year to pick up a Kyoto Prize for his LCD innovations. Nicknamed Japan's Nobel Prize, it came with $425,00

George Heilmeier won the Kyoto Prize for his LCD breakthroughs at RCA—which lost out to Asian rivals

After RCA, Heilmeier expanded his horizons, heading the Defense Advanced Research Projects Agency from 1975 to 197 "We did some really interesting stuff at DARPA," he says, som of which he still can't discuss. Just before leaving, he was at th hush-hush Area 51 airfield near Nevada's Groom Lake when the first stealth plane took flight—research that spawned the famed F-117 stealth bombe

Heilmeier's next stop was chipmaker Texa Instruments Inc., where he was promoted to chief technology officer in 1983. His strategies helped TI survive the 1980s, when Japanese rivals decimated the U.S. semiconductor industry, often by selling chips in the U.S. at below-cost prices.

As a new decade dawned, Heilmeier says h "got the bug that I wanted to run my own company." In 1991 he joined Bellcore Corp. as CEO, piloting its transition from research house for the Baby Bells into a competitive and profitable research powerhouse. He retired in '97 after Bellcore (now Telcordia Technologies Inc.) was acquired by SAIC Inc., a research outfit with hefty defense contracts. He still consults for SAIC and Telcordia, among others

Heilmeier is generally upbeat about the outlook for U.S. science. But he does have some concerns. "There's more hype in research than ever before," he says. "A lot more." Nanoelectronics is especially guilty, he believes. "The hypemeisters may be good at winning funding, but you don't win by dumping in money. You win with insightful ideas." ■

–By Otis Por

BusinessWeek online For a Q&A with George Heilmeier, go to www.businessweek.com/extras

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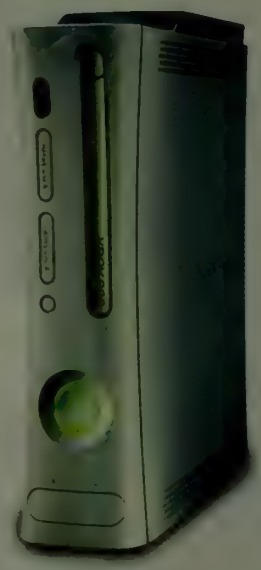
BY STEPHEN H. WILDSTROM

Xbox: A Winner Only at Games

The Xbox 360, released to frenzied hordes of buyers on Nov. 22, is charged with a dual mission for Microsoft. Coming out several months ahead of Sony's PlayStation 3, the new Xbox is aimed at letting Microsoft dominate the game console market as well as giving the company control over the digital living room. It is more likely to succeed at the former than the latter.

Personal-computing technology seems as if it has been nearly static for the past few years. But the Xbox 360 displays the great progress in processing power and graphics that has occurred in the four years since the original version shipped. The first Xbox was a bare-bones PC with a Pentium chip and a cheap but powerful nVIDIA graphics adapter. The 360 uses an entirely new design built around a custom IBM processor that crams three Power PC processors onto a single chip, plus a custom graphics processor from ATI.



The results are striking. The Xbox 360 ($299 for the basic model, $399 for premium) generates high-definition video. It's at its best with the bewildering but beautifully drawn role-playing fantasy *Kameo: Elements of Power* ($50 from Microsoft Game Studios), where it approaches cinematic 3-D animation. *Call of Duty 2* ($60 from Activision), a shoot-'em-up in the guise of a history lesson, offers highly detailed backgrounds and realistic smoke effects as you fight your way through major battles of World War II. Soldiers are more crudely rendered, but they emit delicate spurts of blood when hit. (They also shout a lot, but never swear.)

About 20 game titles for the Xbox 360 were available at release or are due shortly; all are priced at $50 or $60. Many, but not all, original Xbox games will run on the new console if equipped with an optional hard drive, but they look clunky compared with games written for the 360.

UNLIKE THE ORIGINAL BLACK-AND-GREEN Xbox, the 360 is almost handsome. Its off-white-and-silver housing is about the size of a VCR and can be used either vertically or horizontally. If it doesn't exactly fit in with your home-entertainment system, it won't stand out like a sore thumb, either. The premium edition comes with a wireless controller (as well as a 20-gigabyte hard drive for storing saved games, a headset, and a TV-style remote control) so you won't have that ugly, easy-to-trip-over controller cable strung across your living room floor.

It is important to Microsoft that the new Xbox integrate well into the living room or family room because it is the vanguard of the company's latest charge into digital entertainment. In addition to playing games, the Xbox 360 serves as a DVD player and, when networked to a Windows Media Center PC, can display photos or play music stored on the PC and even show live or recorded TV.

The heart of Microsoft's vision is a PC running Windows XP Media Center Edition, which can dispatch music, photos, live or recorded TV, or other videos to different devices on your home network. The new Xbox fits right in, pulling TV signals from your PC, for example, and showing them on any screen. It's simple to set up, and you can get it connected in less than five minutes. Although video quality suffers a bit from the compression required for moving it on the network, it's not bad, even over wireless—provided you have a strong signal.

The 360's graphics are fantastic, but it's not ready to rule the living room

There are some shortcomings: The Xbox makes a racket—especially its cooling fan. This is O.K. during game play but not when you're watching TV or listening to music. Worse, there are some basic flaws in Microsoft's grand vision. Media Center has very limited ability to handle high-definition programming. And if you have the Xbox sitting there next to your HD display and cable or satellite set-top box, you don't need the expensive Media Center setup.

Microsoft may be overreaching in its ambitions for the new Xbox, but it's really about the games: The company expects to sell 3 million or so of them in the next month. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Modern (Sigh) Media Maturity

You are a Medium. ¶ You are a Mature Medium. ¶ It took you decades to get where you are. You have the corporate version of middle-age spread. But you do one thing very well, or at least well enough. ¶ Once this was enough to deliver a steady, satisfying profit stream far into the future. But today your customers have other options. The younger ones don't

recognize your charms. (How could they overlook you? You are a Mature Medium.) Your advertisers are all atwitter about Yahoo! and Google and on-demand. You were once in demand, you recall sourly. You now know this isn't the same thing.

The wrinkles on your forehead dig in deeper. You are not used to losing control.

Your mood darkens further when you hear what some former members of your fraternity now say. Jeff Jarvis used to run the online arm of Advance Newspapers, a 25-paper chain that publishes dailies in Cleveland and New Orleans. (Newspapers. Now there's a Mature Medium.) He quit to dream up new ventures and run his blog. Now he says things like: "Since Gutenberg, the media industry has been based on control. The Net blows that up." The issue: Traditional media's "old structure is not built for it."

Neither are you, you think. A lack of control is bad for a Mature Medium.

Right?

AT YOUR DESK, YOUR MIND WANDERS. You catch sight of your car gleaming in the parking lot. Automobiles: a Mature Industry. One that for decades shoveled dollars by the hundredweight toward you, the Mature Medium.

Your sales reps tell you that Suzuki Motor is advertising on a site called Autoblog.com. It's buying ads there that allow Web surfers to comment on these ads and the vehicles they're promoting. Sure enough, this means some ultra-snide comments get posted about them for the whole world to see. But they keep advertising there.

Something about the Web makes former allies act strangely.

You remember, back in the 1990s, all the Web plays—the half-forgotten names like theglobe.com and geocities.com—that had a business plan that roughly went like this: Allow people to build their own Web sites. Sell ads around them.

For a while, this made you nervous. For a while, Net stock prices made you feel poor. But reality set back in.

You hope that will happen again. But Intermix Media, which owns MySpace, gets bought by Rupert Murdoch's News Corp.—Rupert Murdoch!—for $580 million. Near as you can tell, MySpace is just a bulletin board where teens and twentysomethings get their bands signed and get themselves hooked up. But your kids love it. A place where users create the content looks more and more like the best way to reach young people.

You can't imagine how this happened.

You can't imagine letting people leave comments about you for everyone to see. You can't imagine rank amateurs' content being more attractive than that produced by a Mature Medium. (You silently scream "It took me decades to get where I am!")

You're saying I have to lose control of my medium to gain it? Get outta here!

You can't see that News Corp. and Suzuki have calculated—zen like—that the only way to maintain control is to give it up. That they realize media go both ways now. That they can't hide behind their accustomed walls. To do so may protect your flank, but at the risk of closing yourself off to the Next Big Thing.

You remember when you were the Next Big Thing. But these days the young grads who once flocked to your door cross the street to avoid you.

You are a Mature Medium, and you don't understand why.

Sometimes—though you dare not admit this to anyone—you fear things have gone wrong. Although it's hard, you are always able to put these thoughts out of your mind.

Things are changing fast. But this won't affect you.

You are a Mature Medium.

It took you decades to get where you are.

They can't take that away from you.

Right? ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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SAMSUNG

TheBarkerPortfolio

BY ROBERT BARKER

Low Profiles, High Yields

Gigantic General Electric recently raised its dividend a fat 14%. A few days later, little Lancaster Colony upped its payout, too. A maker of packaged foods, candles, and car parts, Lancaster's increase came to just 4%. In one way, though, Lancaster exceeded GE: It has hiked the dividend now for 43 straight years, vs. GE's 30.

Such consistency makes both companies "Dividend Aristocrats," in the view of Standard & Poor's. Since the early 1970s, S&P has tracked stocks that regularly boost dividends; those that do so for at least 25 straight years it dubs Aristocrats. Few make the grade. Of more than 6,000 listed U.S. stocks, just 85 qualify. In November, S&P took all of this a step further, unveiling a stock index—the S&P High Yield Dividend Aristocrats—comprising the 50 highest-yielding Aristocrats. It caught my eye, not because I didn't know such Aristocrats as GE and Johnson & Johnson to be sterling sources of dividend income, but because I wondered: Which Aristocrats have I missed?

Plenty, it turns out. Of the 50 stocks, Lancaster and a dozen others are too small to make S&P's widely followed 500-stock index. And three of these—ABM Industries, Northwest Natural Gas, and Piedmont Natural Gas—aren't even big enough to make the S&P MidCap 400-stock index. With this baker's dozen of lesser-known Aristocrats in hand, I went to work to see which looked like best bets (table). Here are my favorites:

Little-Known Aristocrats

COMPANY (SYMBOL)	PRICE	YIELD	PAYOUT RATIO
ABM Industries ABM	$20.83	2.0%	35%
Associated Banc-Corp ASBC	33.10	3.3	44
Black Hills BKH	36.16	3.5	158
Hillenbrand Industries HB	49.47	2.3	34
Lancaster Colony LANC	38.65	2.6	37
Mercantile Bankshares MRBK	59.77	2.5	45
National Fuel Gas NFG	31.48	3.6	50
Northwest Natural Gas NWN	34.50	4.0	60
Piedmont Natural Gas PNY	23.14	3.9	73
RPM International RPM	18.58	3.5	70
Vectren VVC	27.34	4.4	71
WGL Holdings WGL	30.21	4.4	66
WPS Resources WPS	53.76	4.2	43

Data: Capital IQ, Standard & Poor's

» ABM Industries. This San Francisco company sells its janitorial, engineering, security, and parking services—does Ampco System Parking ring a bell?—to office-building operators nationwide. Revenue in the fiscal year ended Oct. 31 is estimated above $2.6 billion, according to S&P's Capital IQ data unit, up from $2.4 billion in the prior year. ABM's balance sheet shows no debt and cash of $43 million. Near $21 a share, the company is selling for less than 0.4 times its enterprise value.

» Associated Banc-Corp. A leading community bank in Wisconsin, Associated has been growing steadily both internally and via selective acquisitions, which have taken it into Minnesota and Illinois. With short-term interest rates rising and long-term rates flattish, all banking companies are being squeezed. Associated has been managing nicely, however, by controlling costs and loan quality. Its write-offs so far this year are running at nearly half of last year's rate. The stock, near 33, is 12 times next year's estimated earnings.

» Hillenbrand Industries. This is an easy company to overlook, given that it makes coffins, urns, and other items for burials and cremations. Funeral products and services today make up about a third of revenue; the rest comes from sales and rentals of hospital beds and other health-care equipment. Near 50 a share, the stock is trading at 15 times estimated earnings (before an expected legal settlement) for fiscal 2006, ending next September.

» Lancaster Colony. With no borrowings and $156 million in cash and short-term investments, this diversified manufacturer—Jack Daniel's mustard and Rubber Queen auto floor mats are two of its brands—is set in December to pay out a $2 special dividend. With higher energy, freight, and raw material costs, profit margins have been suffering, but the stock has already reacted, falling under 40 from a 52-week high in September above 46. Wall Street sees Lancaster earning $2.40 a share in fiscal 2006, ending in June.

Just because these companies have raised dividends for at least 25 straight years naturally is no guarantee they will keep it up. Investors who want to spread their bets more widely can check out a new exchange-traded fund, the SPDR Dividend ETF (symbol: SDY). Sponsored by State Street Global Advisors, it tracks the S&P High Yield Dividend Aristocrats index. The fund's annual management fee is 0.3%, and it yields about 3%—a noticeable bump up from what you can get from J&J or GE. ■

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JAMES C. COOPER & KATHLEEN MADIGAN

Why Economic Growth 's Galloping

onsumers and businesses have lots to spend as they get financially stronger

U.S. ECONOMY The economy is proving as unstoppable as the 11-0 ndianapolis Colts. Consumers have kept spending even in the wake f sharply higher energy prices and after their confidence was ummeled by this summer's hurricanes. And despite initial worries ver demand generated by the storms and oil hikes, businesses

ntinue to invest in new equipment and add to eir payrolls.

The economy's resilience is especially evident in the test update on growth from the Bureau of Economic nalysis. The BEA's second look at third-quarter gross omestic product showed that the economy grew by a bust 4.3% annual rate, even with the business utdowns caused by Hurricanes Katrina and Rita. And al GDP in the fourth quarter appears to be increasing at nealthy pace of greater than 3%. For all of 2005, real DP is on track to expand by 3.7%.

That's a bit higher than the 3.5% projected by the onomists surveyed by *BusinessWeek* at the end of 2004. ut what's more revealing is that the consensus forecast as predicated on oil prices slipping back to $39 per rrel by now and the Federal Reserve hiking its target r the federal funds rate to only 3.4% by yearend. stead, oil remains well above $55 and fed funds have ready reached 4%, with more hikes on the way.

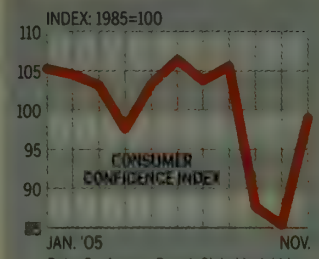
So why has the economy performed above expectations nid unexpected developments? The main explanation ems to be that, despite the Fed's desire to tighten onetary conditions, consumers and businesses, on erage, still have access to cash, whether through cheap orrowing, better income and profit growth, or rising ousing and stock market wealth. Accommodative nancial conditions are proving to be the economy's eyton Manning, quarterbacking the steady forward novement in demand.

Attractive bond yields, a rising stock market, robust rofit growth, and, thanks to the recent fall in oil prices, nore household buying power are allowing consumers nd businesses to spend. Since nothing in the outlook uggests any sharp reversal in these stimulative trends, ne economy should enter 2006 with much more nomentum than seemed likely only a few months ago.

MUCH OF THAT STRENGTH, surprisingly enough, will e concentrated in the consumer sector, which has veathered the shocks of 2005. The GDP revisions show eal consumer spending increased at an annual rate of .2% in the third quarter. That's better than the 3.9% ace previously estimated, and it occurred during a quarter when gasoline prices hit more than $3 per gallon.

Fourth-quarter spending did get off to a weak start, but the major reason was that domestic auto makers removed the generous financing deals that had propped up sales over the summer, causing a huge drop in car buying from an exaggerated level. Consumers are out again shopping, as indicated by the generally upbeat sales reports from Black Friday and Cyber Monday.

A PRE-HOLIDAY BOUNCE IN CONFIDENCE



Data: Conference Board, Global Insight Inc.

One reason consumers may be willing to spend is because they are feeling more optimistic about the economy. The Conference Board's index of consumer confidence jumped to 98.9 in November from 85.2 in October (chart). The nearly 14-point gain was the biggest increase in 2½ years. The indexes covering current economic conditions and consumers' assessment for the next six months both rose sharply.

The board attributed the upbeat sentiments to a more than 40¢ drop in the price of a gallon of gas and better job growth. Fewer households rated jobs as "hard to get" in November. By the end of the month, regular gasoline had dropped to an average of $2.15 nationally, and it had dipped below $2 in some parts of the country.

BESIDES THE GAIN IN INCOME resulting from better job growth, households are also benefiting from the recent rally in the bond market. Bond traders have defied Fed policymakers this year by keeping long-term rates low even as the Fed was hiking short rates. Long yields began to edge up in the fall, when inflation worries cropped up, but yields have since fallen back. Cheap bond yields have been one key financial condition that has stimulated this economy, especially via housing.

Make no mistake, the housing sector is cooling, but activity will slow in fits and starts. Look at what occurred in October. Sales of existing homes fell off as expected,

dipping 2.7% to a still impressive annual rate of 7.1 million. But new home sales jumped by 13%, to a record annual rate of 1.42 million.

Buyers, worried that rates would continue to rise, may have rushed to close a sale. But if bond yields remain low, mortgage rates could stay close to 6% in coming weeks. That would provide continued support for housing demand. More important, the dip in rates will encourage some additional refinancing activity that will bolster consumer spending as homeowners extract extra cash from their homes.

CONSUMERS AREN'T CARRYING this economy alone, though. Businesses are also contributing more to growth than they did in previous years. According to the new GDP data, inventories fell by the biggest amount since the 2001 recession. Rebuilding stockpiles will require more gains in production in coming months. And business investment in plant and equipment remains strong.

In particular, equipment outlays grew at a 10.8% rate in the third quarter, up from the original estimate of 8.9%. The pace could be even faster this quarter, based on the October rebound in capital-goods orders and shipments, after being depressed in September by the hurricanes and the strike at Boeing Co. Even excluding aircraft, equipment orders continue their steady uptrend.

Easy access to money, whether from good profits growth, abundant cash flow, or cheap borrowing costs, has enabled companies to boost their capital spending budgets. The BEA's tally of third-quarter corporate profits, which accompanied its GDP update, showed th economywide earnings fell by $45 billion from the second quarter. However, that included $151.2 billion i hurricane-related losses. Adjusting for the BEA's estimates of storm losses incurred both this year and in last year's third quarter, profits from current productio are up 21.4% from a ye ago, the strongest showing in three years (chart).

HOW THE STORMS AFFECTED EARNINGS

Data: Bureau of Economic Analysis, BusinessWeek

But the really interesting feature of la quarter's earnings is th way profit margins helc up despite the hurrican and surging energy cos Profits of nonfinancial corporations remained an exceptionally high 13.2% of the sector's GI That was down only slightly from the record 13.3% hit i the second quarter, and it continues to surpass the previous record reached back in 1997.

With strong earnings fueling capital spending, and with improving confidence and better job markets powering consumer outlays, overall demand will be strong enough to energize the economy heading into 2006. And while only time will tell if the Colts will rema unbeaten, little in the data suggests that the economy w be thrown for a loss anytime soon. ■

EXCHANGE RATES

The Dollar Is Still Defying Gravity

ONE BIG SURPRISE of 2005 has been the rise of the dollar. Higher interest rates in the U.S. vis-à-vis the rest of the world have partially bolstered the currency. But now that other central banks are set to begin raising rates, the question becomes whether the greenback will retain its value in 2006 given the huge U.S. current-account deficit.

So far this year the dollar is up 3% on a trade-weighted basis and it has jumped 13% against the euro and 15% against the yen. Foreign companies and investors still have confidence in the American economy. It's their investments that are lifting the dollar and could offset any weakness resulting from higher interest rates in Europe and Japan (page 84).

THE U.S. DOLLAR: 2005's COMEBACK KID

Data: Federal Reserve Board

A good sign of that confidence is foreign direct investment (FDI), which flows into hard assets such as equipment and structures. In the first half, FDI in the U.S. totaled $47.8 billion, and for all of 2005 it should equal or exceed last year's total of $95.9 billion. What's more important, says Joseph Quinlan, chief market strategist at Bank of America Corp.'s Investment Strategies Group, is that the data refute the notion that China and the U.S. are fighting for funds. FDI into China should total about $55 billion in 2005, down from $60.6 billion in 2004.

Global investors also continue to snap up U.S.-issued securities such as Treasury bonds an corporate equities. In September, net foreign buying of U.S. securities hit a record $101.9 billion. Treasury data show that Britain has been a big purchaser of U.S. securities, but analysts at Capital Economics in London think that these inflows migh be the result of excess oil revenues from the Middle East and Russia being channeled through Britain and into U.S. markets. If so, a reversal in o prices could result in a dip in foreign purchases of U.S. securities.

The falloff, however, may not be enough to cause any sudden drop in the dollar. That has been a fear in 2005, given the growing U.S. current account deficit, the broadest measure of America's IOUs to the rest of the world. The day of reckoning over its huge imbalance looks likely to be postponed as long as foreign investors are content to park their cash in the U.S. ■

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Bush's Immigration Strategy An amnesty by any other name would smell as sweet. That's the lesson of **President George W. Bush's** Nov. 28-29 visit to the border hot spots of Tucson and El Paso (above). There, the White House downplayed its two-year-old proposal for guest worker status for some of the 11 million illegal immigrants in the U.S. Because GOP House hard-liners hate the guest worker plan—backed by industries such as agriculture, hotels, and construction—it has gone nowhere in Congress. So the President stressed get-tough measures such as the planned addition of 1,500 border agents.

The White House intends to stand aside as the House passes a strict enforcement measure with no guest worker provision. But take heart, business: The idea is that the Senate would follow early next year with a bill allowing undocumented workers to stay in the U.S. and work toward citizenship. The two approaches would then be combined. It wouldn't be amnesty, proponents say, because the illegals would have to pay a nominal fine in order to stay.

See "The melting pot is still melting," page 67

Icahn Goes to War Hollywood has nothing on **Carl Icahn** when it comes to noisy action. Escalating his fight to force **Time Warner** to boost its somnolent stock by restructuring, the onetime greenmailer says he enlisted investment bank **Lazard** and its sovereign, **Bruce Wasserstein,** to unhorse a majority of the board—and perhaps toss CEO **Richard Parsons.** So far, Icahn's crusade hasn't caught Wall Street's attention or goosed the stock since he said in mid-August he had the company in his sights. Icahn's group controls nearly 3% the stock and has pressed Parsons to buy back $20 billi and unload its cable unit. Icahn promises "an all-out pro battle" before the next annual meeting in mid-2006.

See "Fighting words for Time Warner" (BW–Nov. 2

Surprising Economic Numbers The U.S. econon seems stubbornly stuck in high gear, with new reports GDP growth, durable-goods orders, new-home sales, cap tal investment, and consumer confidence bringing joy dismal scientists. So what's with the simultaneous, scarif ing news of monster job cuts at such giants as **General M tors** (30,000), **Ford** (7,000), and **Merck** (7,000)? They're co centrated in troubled industries. In fact, mass layoff defined as hitting more than 50 workers at one employe in October hit their lowest level in five years.

See "Why economic growth is galloping," page 2

RIM's Latest Setback A nice round billion buck That's how much analysts figure **Research in Motion,** mak of the much-loved **BlackBerry** wireless device, may no have to pay **NTP** to end a bitter patent case. On Nov. 30 district court judge in Virginia ruled that a $450 millio settlement that fell apart in June isn't enforceable. He als declined to delay the case. Next up: proceedings o whether to squash BlackBerry's service in the U.S. RI says it has a software workaround that would keep Blac Berry running, though it just finished testing. But its fortunes in court could soon lead RIM to fork over.

China's Toxic River The 50-mile slick of benzene an nitrobenzene fouling the **Songhua River** finally cleared th city of **Harbin** on Nov. 27, but there's lots more poison wher that came from. After 25 years of frenetic growth, 70% the nation's waterways are polluted, and smog kills tens thousands a year. Even Beijing recognizes the crisis—on reason it has allowed environmental groups to proliferate Still, it fears a strong movement. After initially letting th Chinese press report openly and angrily on the Harbi mess, Beijing has clamped down on coverage. Expect mor disasters to float to the surface.

See "China: Choking on pollution's effects,
www.businessweek.com/go/tb

A Union Victory Hardly anyone thrills to the labor an them *Which Side Are You On?* these days, but they may b singing it soon in Houston—translated into Spanish. O Nov. 28 *The New York Times* reported that 5,000 mostly im migrant building cleaners are poised to join the **Service Em ployees International Union** in a city where unions are a scarce as caribou. The country's largest labor group em ployed a series of pressure tactics to persuade Houston' four largest janitorial companies to forgo the typica scorched-earth resistance to unionization of the workers who often make the federal minimum wage of $5.25 a hour. Similar tactics helped the SEIU double the pay of jan itors in New Jersey and other states in recent years, but th Texas win marks an unusual advance in the South.

olling In Tax Receipts State and local governments ve long been slaves to the boom-and-bust cycle, and ght now they're riding the upswing. With investors reap-g capital gains and companies churning out profits, tax venues are up more than 7% in the first nine months of is year, a far cry from the sad collections of 2000-03. ok for euphoric legislatures to trim taxes when they get ck to work in January. But as spending, especially for edicaid, continues to strain budgets, tax relief will be odest and temporary. States that really want to break the cle would probably have to make income taxes more pro-essive and mend the loophole-ridden corporate-tax ructure. So far no state has serious plans to tackle broad-sed reform in 2006.

hy Gold Looks Golden Gaga for gold even at around 500 an ounce, its highest price in 18 years? You could buy gewgaw—or you could make a real statement and buy a mining company. That's what **Barrick Gold** is trying to do with a hostile $9.2 billion offer for its fellow Canadian miner, **Placer Dome**. On Nov. 30 the *Toronto Globe & Mail* reported that Denver-based **Newmont Mining,** the world's biggest gold producer, is also mulling a bid for Placer Dome. (Newmont declines to comment.) Gold prices are shining because of lust for jewelry—especially in In-ia—and fears that strong economic growth could kindle igher inflation. The lustrous metal is still far from its 1980 eak of more than $800.

HONG KONG DISPLAY

See "As precious metals go, so goes jewelry?" www.businessweek.com/go/tbw

pitzer Watch Fallout from **New York State Attorney Gen-ral Eliot Spitzer's** plentiful probes came thick and fast this veek. On Nov. 22, **Warner Music** agreed to pay $5 million o settle charges that it paid radio programmers to spin s tunes. **Sony BMG** settled in July. On Nov. 25, Spitzer aid he won't bring criminal charges against **ex-AIG chief laurice "Hank" Greenberg,** instead concentrating on the lready filed civil case. And on Nov. 29, **Federated Investors** aid $100 million to settle allegations of improper mutu-l fund trading, the 14th company to come to terms in hat inquiry. Spitzer, who's running for governor, may ave lost his aura of invincibility lately, but he's still carv-ng notches on his gun.

able à la Carte? Cable companies are a-tremble after **CC Chairman Kevin Martin** fired a broadside on Nov. 29. Re-ersing his predecessor's stand, Martin said his agency vould issue a report concluding that selling cable chan-els individually, instead of in packages, can lower rates or consumers and allow them to reject risqué networks hey find objectionable. While it's unlikely that à la carte cable will arrive soon, Martin's bombshell fuels the firestorm in Washington over indecent programming and fans consumer pressure for more family-friendly options.

See "The FCC's cable crusade continues," www.businessweek.com/go/tbw

Forging a Steel Deal When your biggest customers go global, you'd better follow. That's what Europe's steelmak-ers are doing in pursuit of fast-globalizing carmakers—and that'll soon mean the end of Canada's No. 1 steelmak-er, **Dofasco,** as an independent. Whose furnace will swallow up Dofasco isn't clear. Germany's **ThyssenKrupp** agreed on Nov. 28 to pay $4.1 billion for the Hamilton (Ont.) compa-ny, topping a hostile bid by **Arcelor** of Luxembourg. Arcelor may counter. The surprise tussle has triggered heavy trad-ing in **U.S. Steel** shares as speculators bet it could fall next. If it were to be sold, it'd join **Bethlehem, LTV,** and **Inland Steel,** which today belong to **Mittal Steel** of the Netherlands.

EBay v. MercExchange Companies will line up on op-posite sides of a potent patent case headed for the U.S. Supreme Court. In 2003 a jury found **eBay** liable for in-fringing a patent held by MercExchange. The justices on Nov. 28 agreed to ponder whether courts in such situa-tions should issue injunctions halting use of the infringing technology, or whether they can consider other remedies such as monetary damages. For eBay, the case is important but doesn't threaten its basic operations. But many tech enterprises say the prospect of a court-ordered kibosh on all or part of their business forces them into outlandish settlements. Big drugmakers, on the other hand, tend to favor injunctions. Look for a ruling by June.

Frenzy of the Week

Give thanks and go shopping. That great American ritual got even nutsier this **Black Friday,** so-called because it's the day retailers traditionally went into the black for the year. Many big-box chains, including **Wal-Mart,** threw open their doors at 5 a.m. **Target** sent out "tuck-in" phone calls on Thursday to be sure the most eager got rested, then rang back in the wee hours to wake them in time for the 6 o'clock stampede. Target's targets could choose to hear the voice of a sexy swimsuit model, a Mariachi band, or Kermit the Frog, among others. Such gonzo marketing—and deep price cuts—paid off for discounters, which rang up bang-up numbers, although retail con-sultant Candace Corlett sniffs desperation: "It's like the panic button has been pushed." Sales for the rest of the weekend weren't as strong. And mythical or not, **Cyber Monday** (*UpFront, page 11*), capped a fat four days for e-tailers. **Visa International** says e-tail charges on its card were up 26% over last year.

See "E-tailers try new holiday tricks," page 46

EXECUTIVE SUITE

FAT MERGER PAYOUTS FOR CEOs

Top execs at companies being acquired are reaping windfalls. Whose interest is being served?

BY EMILY THORNTON

AS GILLETTE'S CEO, James M. Kilts had reason to expect a lucrative 2005, with annual pay likely exceeding $23 million. But this turned out to be an especially eventful year: The razor maker, one of America's best-known brands, agreed to be acquired by consumer-products giant Procter & Gamble Co. For selling Gillette Co., Kilts received even more than his anticipated pay—a lot more. The companies promised him a package valued at $165 million, including stock options and severance. On top of this, P&G has said it will give him stock and options worth $23 million in return for serving as its vice-chairman for one year and agreeing not to join a rival before 2009. Excluding $6.5 million he stands to earn during his year as vice-chairman, Kilts could eventually pocket an astounding $188 million.

As mergers roared back in 2005, so did CEO payouts triggered by the deals. In Boston, where Gillette is based, the Kilts bonanza heightened local outrage over a major hometown company surrendering its independence. "It is obscene what he is getting paid," says retired Gillette Vice-Chairman Joseph E. Mullaney.

BURIED IN THE FINE PRINT

KILTS HELD HIS FIRE until after Gillette shareholders had given the acquisition their overwhelming approval. Then in September, he let loose in a speech to the Boston Chamber of Commerce. Complaining that he had become "Boston's piñata," he argued that he had earned his handsome pay by creating billions in shareholder value since arriving at Gillette in 2001. The P&G deal "will be the greatest merger in consumer products history," he said. "We make no apologies." Given his success at Gillette, "Kilts had become the Michael Jordan of corporate executives," says Arthur F. Golden, an outside lawyer for the company. "He was a very scarce and desirable superstar, and that is why he gets paid so much."

Unlike the public clash in Boston, payouts to CEOs and their top lieutenants typically attract little attention amid the merger swirl—beyond often-opaque references in company filings. Georgia-Pacific Corp.'s CEO, A.D. "Pete" Correll, will receive a $92 million package when the company's sale to Koch Industries is completed, according to an estimate by executive-pay consultant Delves Group. Toys 'R' Us Inc. CEO John H. Eyler is set to receive cash and benefits worth about $63 million as part of the struggling toy retailer's purchase by an investment group that includes Kohlberg Kravis & Roberts & Co. And Bruce L. Hammonds, the CEO of MBNA Corp., was promised compensation valued at $102 million in connection with the credit-card company's acquisi-

BusinessWeek online For breakdowns of these merger payouts and the full version of the table on page 36 describing potential payouts promised by other large companies, go to www.businessweek.com/extras.

Data: Shekhar Purohit at Delves Group. Amounts include estimated values of benefits such as projected total cost of annual pension and retirement payments and taxes paid by companies.

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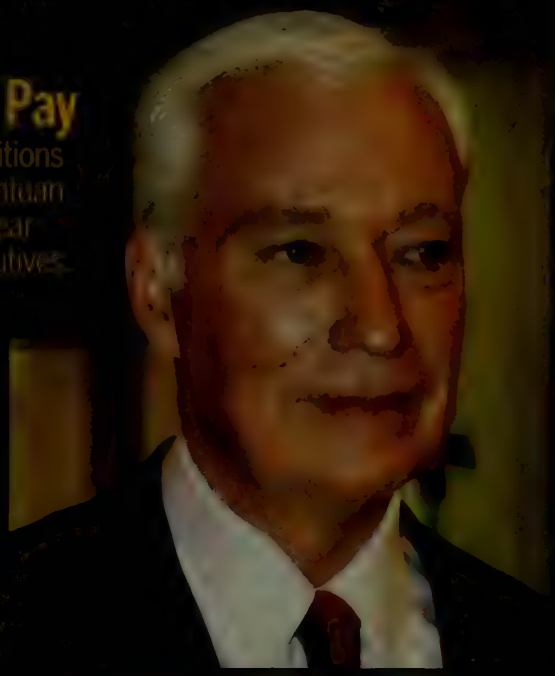

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LLETTE
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Bruce L.
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MBNA
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D. Correll
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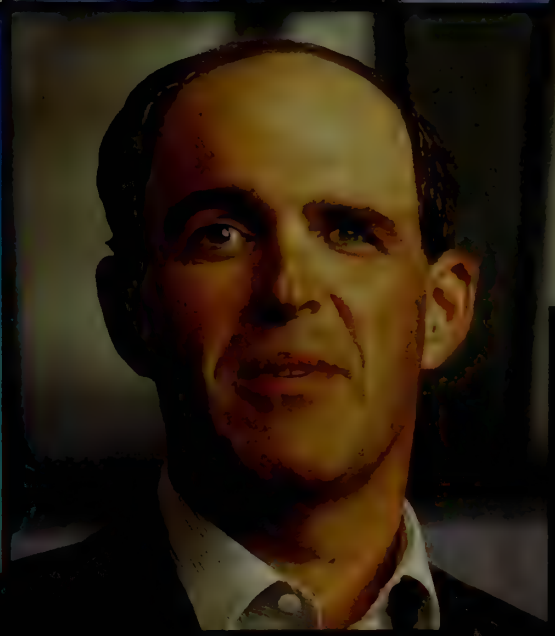


Michael D.
Capellas
MCI
$39
MILLION

tion by Bank of America Corp., according to Delves Group. MBNA shareholders approved Hammonds' payout on Nov. 3 during a meeting on the merger at the company's Wilmington (Del.) headquarters. Not a single question was asked during the 10-minute gathering.

Kenneth D. Lewis, CEO of Bank of America, says he generally opposes special bonuses, though his company has paid them to Hammonds and others. "Why should I as a CEO have a safety net that my teammates don't?" he asks. Several years ago he dropped such protections for himself when he chose to work without an employment contract. But he's resigned to doling out merger windfalls. "I just think of it as a price you have to pay" to get a target company's CEO to submit to being taken over, he says. "My wife asks me after some of these deals: 'Tell me again—who won?'"

Even as many investors assume that they've seen the end of the executive-pay excesses that flourished during the late-1990s bubble, a new Gilded Age is under way. The explosion of merger-related payouts raises the question of whether CEOs are doing deals more for their own benefit than for their shareholders, says James P. Melican, president of Proxy Governance Inc., which advises pension funds and other institutional investors. "Mergers are tarnished when it appears that managements have negotiated lucrative employment contracts for themselves with the acquiring company."

Companies that provide the payouts dispute that, of course, and some contend that the extent of their largesse is exaggerated. Georgia-Pacific and a number of others point out that the bulk of their CEO packages consists of unvested stock and options from which top execs eventually would profit regardless of whether there is a merger. But Delves Group and most other executive-pay experts say that to get a full picture of how some CEOs benefit from mergers, it's appropriate to include stock and options whose vesting is accelerated. Eyler of Toys 'R' Us and Hammonds of MBNA declined through spokespeople to comment.

The roots of this latest twist in lavish executive pay can be traced to the 1980s. In response to threats of hostile takeovers, many companies promised CEOs "golden parachutes": special payments if control of the company suddenly changed hands. Corporate boards defended the arrangements as necessary to prevent executives from resisting reasonable deals to protect their turf and paychecks.

SERIAL DEALMAKERS

TODAY, THOUGH, MOST merger-payout provisions look like golden bungee cords. They apply to friendly deals, and CEOs often bounce right back to the newly merged combination, where they continue to earn impressive annual paychecks. In addition to Gillette's Kilts, who is staying with P&G through next fall, MBNA's Hammonds will remain at Bank of America to run its credit-card unit. Providian Financial Corp.'s CEO, Joseph W. Saunders, oversees credit-card services at his company's acquirer, Washington Mutual Inc., while collecting an estimated $14 million in merger-related compensation. Without confirming that figure, Washington Mutual said in a statement that "the former Providian board put in place a compensation package designed to reward the management if they created a lot of value for shareholders. Saunders and his team did add a lot of value to Providian."

Some skeptics suggest that supersiz payouts perversely benefit CEOs whos companies' weaknesses made them vul nerable to takeover. "The company [tha has been acquired] is not doing well. Wh would you reward someone for that?" asks Bank of America's Lewis. "Philo sophically, I don't believe in it." But h goes along with it to get deals done.

Others see the tendency as spawnin a generation of serial dealmakers whos specialty is dressing up companies fo sale. Kilts received his Gillette payou just five years after pocketing benefit worth $70 million in connection wit selling Nabisco Holdings to Philip Mor ris (now renamed Altria Group) Michael D. Capellas will receive a $3 million package for selling MCI to Veri zon Communications earlier this year just three years after he collected a $1 million package for selling Compa Computer to Hewlett-Packard. Patrick S McGurn of Institutional Shareholde Services, another adviser to institutiona investors, says the availability of such payouts could influence CEOs to think "What am I doing running the business for the long term when I can just flip i

Platinum Promises

While some CEOs are collecting big merger payouts, many others stand to receive similar packages if their companies are acquired. The promised payouts often include the accelerated vesting of stock and options. Here are estimates by compensation-research firm Equilar Inc. of potential packages from a survey of America's 100 largest corporations:

NAME/COMPANY	MILLIONS	COMPANY COMMENT
William W. McGuire UnitedHealth	**$162**	"It is incorrect to include unvested options of approximately $139 million." Those options eventually would vest when McGuire leaves the company, regardless of whether there is a merger. He is already eligible for retirement.
Robert L. Nardelli Home Depot	**$114**	"Consistent with the company's philosophy of attracting and retaining the highest-performing leadership available, change-in-control provisions are sometimes utilized to provide competitive stability for senior leaders."
J.J. Mulva ConocoPhillips	**$92**	The estimate can't be accurate because it's based on financial assumptions about a hypothetical merger. Mulva would benefit from the change-in-control plan only if he lost his job. His "employment conditions are the same as those for all ConocoPhillips executives."
Gary D. Forsee Sprint Nextel	**$80**	Change-of-control agreements are customary for CEOs at large companies trying to attract and retain top executives. Under Forsee's leadership, Sprint's stock has increased sharply.
Kenneth I. Chenault American Express	**$73**	"We have designed our change-in-control policies to help keep employees focused on their jobs during the uncertainty that accompanies a change in control, to preserve benefits after a transaction, and to help us attract and retain key talent."
Henry M. Paulson Jr. Goldman Sachs	**$60**	The package doesn't include any cash. Paulson, who is eligible for retirement, would retain unvested stock and options with or without a merger. He doesn't have a special employment contract and would receive the same benefits as any other shareholder if the company were sold.

Estimates include promised cash payouts, which are typically multiples of a CEO's salary and bonus, as well as unvested stock and options whose vesting would be accelerated. Value of stock and options is based on share prices at the end of each company's 2004 fiscal year. Estimates don't include vested options, performance shares, company payment of tax bills or retirement benefits.

"It is unseemly r executives to egotiate golden andshakes, articularly at a me when they re asking their orkforce to ear the cost of ansition through elt-tightening and] layoffs."

–Brandon J. Rees
AFL-CIO
research analyst

"To keep management ahead of the game [and] to get ultimate shareholder value, you want a management team that's economically indifferent to whether or not they will have a job when the deal is done."

–James Rogers,
CEO of Cinergy Corp.

id make a lot more money?" The Capellas MCI payout eflects his success in engieering the largest corporate rnaround in history and fulling his fiduciary duty of maxnizing stakeholder value," a mpany spokesman said. Alia declined to comment.

To gauge the scope of the erger-payout trend beyond is year's activity, *BusinessVeek* asked compensation-reearch firm Equilar Inc. to our filings by America's 100 rgest corporations and deterine which have promised erger packages to their CEOs. The study nows that roughly half have done so, proiding for an average of $28 million if the mpany is acquired. The Equilar estiiates include how much CEOs would reeive in cash, as well as stock and options hat would vest on an accelerated schedle. The figures don't include vested stock r options or benefits from companywide quity incentive plans.

HE LAST TO KNOW

ORPORATIONS TEND to issue mixed nessages about merger payouts. In lanuage typically buried in annual proxy filngs, they say potential payouts reassure EOs and keep them focused on shareolder interests. But once a merger gets nder way, companies often concede in ifferent filings that the same payouts crete a potential conflict of interest between hareholders and CEOs who now have a uge incentive to complete the deals. hareholders often don't pay attention ntil too late in the process, at which point companies that have agreed to be acquired usually face steep breakup fees if deals are killed.

Some CEOs are quite persistent about negotiating their payouts. Cinergy Corp.'s James E. Rogers discussed his merger compensation, among other topics, with Paul M. Anderson, CEO of acquirer Duke Energy Corp., during at least nine meetings last spring, according to Duke Energy filings with the Securities & Exchange Commission. Asked about his pursuit of the estimated $23 million payout, Rogers says: "To keep management ahead of the game [and] to get ultimate shareholder value, you want a management team that's economically indifferent to whether or not they will have a job when the deal is done. This is the way to compensate them for putting the shareholders in front."

The wave of colossal rewards for CEOs is beginning to generate a reaction from shareholder activists and government. The SEC is weighing new disclosure requirements for CEO pay that would oblige companies to make change-in-control provisions easier to decipher in proxy materials. And some institutional shareholders are pushing resolutions seeking to rein in certain payout provisions.

Typical of investor resentment were the reactions of some AT&T shareholders to word that the company's ex-CEO, David Dorman, would walk away with an estimated $55 million in cash, stock, and other benefits as a result of this year's merger with SBC Communications Inc. California Public Employees' Retirement System, the big state pension plan, earlier had obtained a majority of shareholder votes for a proposal to limit executives' pay packages. Referring to AT&T's slumping fortunes under Dorman's leadership in the last three years, Christy Wood, a senior investment officer at CalPERS, says: "We're not anti-pay. We're anti-pay for failure."

Dorman counters that he forged a merger approved by shareholders and applauded by Wall Street. "We think that we got a good price and a good agreement," he says. AT&T added that, independently of the shareholder resolution, it has pared its merger-payout plan. The company says its benefits are comparable to those of its rivals and that the promise of payouts helps retain talented executives. ■

–With William S. Symonds in Boston; Amy Barrett in Wilmington, Del.; Dean Foust and Brian Grow in Atlanta; and bureau reports

CARMAKERS

WHAT IF GM *DID* GO BANKRUPT...

How investors, customers, and suppliers might fare under Chapter 11

BY DAVID WELCH

AFTER WEEKS OF LISTENING to analysts and pundits beat the drum about the possibility of a General Motors Corp. bankruptcy, Chairman and Chief Executive G. Richard Wagoner Jr. decided he had heard enough. On Nov. 16 he declared in an internal memo to his 325,000 employees that bankruptcy is "unnecessary." There is no plan to file for Chapter 11 protection, Wagoner said flatly, calling such an action "contrary to the interests of our employees, stock- and bondholders, dealers, and our suppliers and customers."

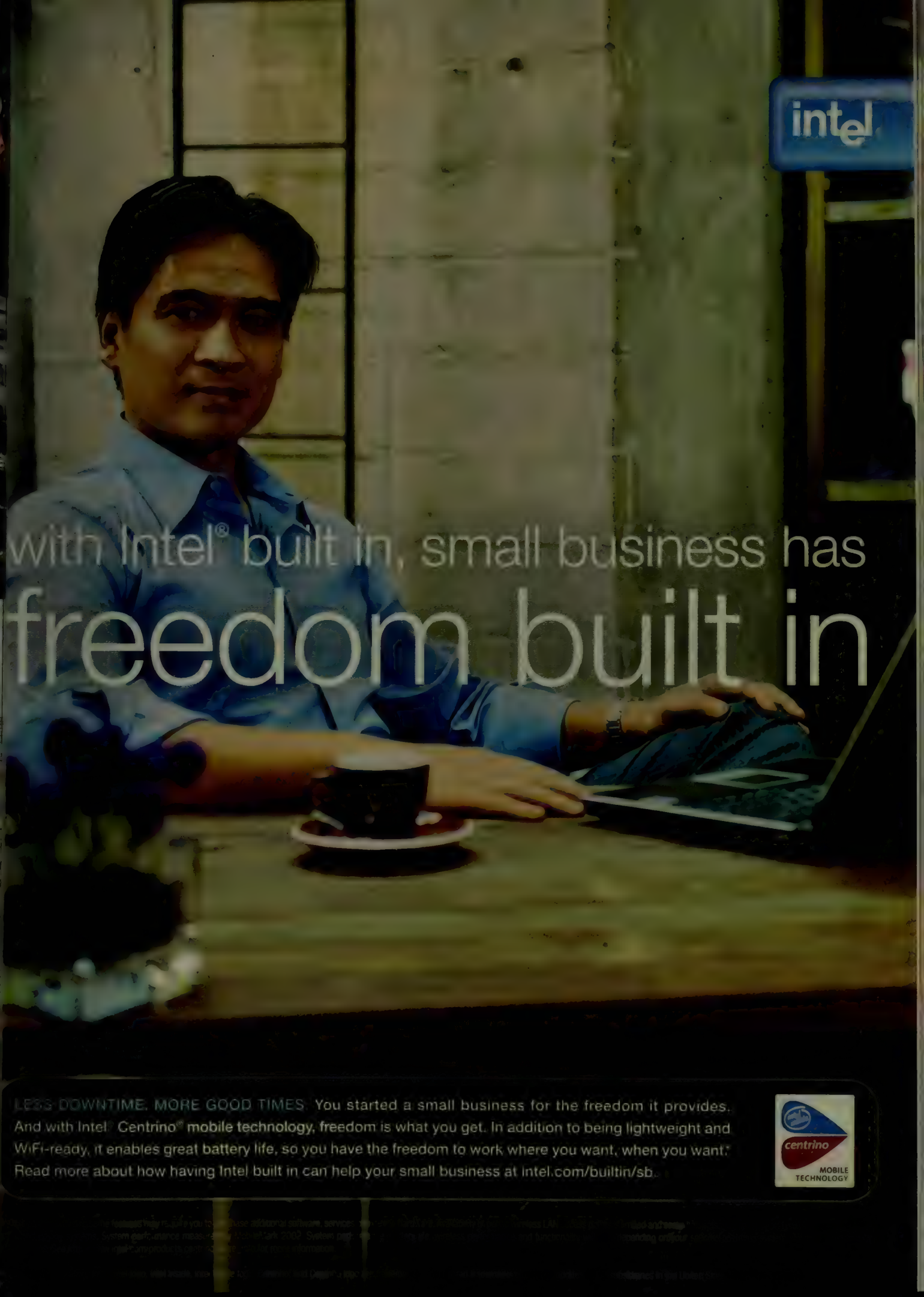
In other words, Wagoner was calling bankruptcy unthinkable. And for a long time, that's exactly the way it seemed. GM has $34 billion in cash and could free up roughly $15 billion more selling various businesses. That alone should be enough to keep the company running for a few years. What's more, its cash-burn rate of $2 billion a quarter will slow down as a recent restructuring, which will eliminate nine factories and 30,000 workers over three years, takes hold.

But despite Wagoner's protestations, investors are clearly starting to ponder the unthinkable. The price of GM's credit-default swaps, which are insurance in case the carmaker can't pay back its loans, have soared in the past month. They now cost a premium of 12 percentage points of the value of the debt that they insure, four times what they cost in January. Few people believe that Washington would help bail out GM, as it did with Chrysler. Investors, suppliers, and employees, meanwhile, are starting to imagine how a GM bankruptcy would unfold and takin steps to defend themselves if it shoul happen. Some suppliers, for example, ar trying to get shorter payment terms fron GM in exchange for lower prices.

ON THE LOT Buyers may worry that GM wouldn't honor warranties

What would a GM bankruptcy lool like? It probably would be the most mas sive Chapter 11 filing of all time—a water shed moment in the history of Americar business, with far-reaching consequence for all of GM's stakeholders. While the di rect impact on the national econom would be relatively modest, the Midwes would be hit hard by the combination o job losses at GM and its suppliers anc benefits cuts for the company's retirees.

Plenty of observers believe that thi suffering would be worthwhile, of course if a stronger company emerged fron bankruptcy. As airlines and steelmaker have done, GM could use Chapter 11 tc rewrite union contracts, potentially en abling it to slash retiree benefits and clos plants without having to pay furloughec workers. The auto maker could ever dump tarnished brands and get bank ruptcy court protection from dealer law suits. "Bankruptcy could do great thing for GM," says William J. Rochelle III, bankruptcy attorney with Fulbright & Ja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MOBILE TECHNOLOGY

worski LLP. But, of course, Chapter 11 is no sure bet. History is full of examples of companies that have emerged from bankruptcy simply to return in a few years. Here's a quick overview of how a GM bankruptcy might unfold for some of the key players:

Customers

ONE BIG RISK of a bankruptcy filing is that it would cast such a pall over GM that sales would plummet. Consumers will buy airline tickets from a bankrupt company, but cars are a long-term commitment. Many buyers would worry (unnecessarily, in all probability) that GM wouldn't be able to honor its warranties. No U.S. carmaker has filed for bankruptcy in decades. But retailers such as KMart and Hechinger and carmaker Mitsubishi all saw sales fall when their financial problems became widely publicized, notes Thomas T. Stallkamp, former Chrysler president and now the industrial partner for private equity firm Ripplewood Holdings LLC.

To stem eroding market share, GM could eventually use the lower costs achieved through bankruptcy to drop prices and lure more buyers, says Diane C. Swonk, chief economist with Mesirow Financial Services in Chicago. But cutting prices further could just exacerbate GM's already severe revenue problems. Its per-vehicle revenue of $21,000 is $3,500 less than rival Toyota's.

Rental car companies, purchasers of about 15% of GM's volume, would get nervous, too. They often sell their used models back to the auto maker. They're worried they would have to liquidate the cars themselves if GM went bankrupt, says Maryann N. Keller, a longtime GM watcher who sits on the board of Dollar Thrifty Automotive Group Inc. And, of course, if the company's retail sales are down, the value of used GM cars would fall, too. "GM should do everything it can to avoid bankruptcy," says Keller.

Suppliers

BIG PLAYERS like parts maker Tower Automotive Inc. and American Axle & Manufacturing rely on GM for a large chunk of their business. If its market share slid more quickly, they would suffer declines in revenue. The carmaker would try to keep the disruption to key business partners to a minimum, but many smaller parts makers could topple into bankruptcy, predicts Stallkamp. He says Ripplewood considered buying one thriving parts maker recently, a company with about $500 million in revenue. But it was too dependent on GM. If the auto maker stopped paying suppliers even just for a few weeks after filing, that company and a handful of others could end up in bankruptcy, he says.

WAGONER Suppliers have seen payment terms stretched to two months already

That's why some parts makers are starting to open talks to get paid sooner. GM has already stretched payment terms out to two months in most cases. Suppliers are also trying to diversify their sales with other auto makers, relying less on a GM that will be downsizing for the foreseeable future.

Smaller parts makers could quickly go bankrupt themselves

Pensioners and Employees

IF GM WENT belly-up, retirees, workers, and taxpayers could all take a hit. Right now, its $90 billion pension fund is fully funded on an accounting basis. But the government-backed Pension Benefit Guaranty Corp., which acts as a safety net for corporate pension plans, says GM is underfunded by $31 billion.

How that would play out in a GM bankruptcy would be complicated. The PBGC could be on the hook for billions i pensions. The agency also could for the Detroit giant to keep funding its ow pension plan even in bankruptcy-though the company could make th case that it should pay less. Still, GM 450,000 retirees would get hit: The may end up with smaller pensio payouts, and their medical benefit as well as the health-care plans of exis ing workers, would most likely b whittled back.

Investors

GM'S CREDITORS would also stand t suffer. The company has $31 billion i long-term debt, most of it due in 202 and beyond. Of $34 billion in cash, $1 billion is in a fund earmarked for health care liabilities. Who knows how muc will be left in a few years? Fitch Rating analyst Mark Oline says GM will have t spend some cash to pay for its an nounced restructuring and could sti have to pitch in to help its former aut parts arm, Delphi Corp.

That raises the possibility that credi tors won't recover their whole invest ment, as was the case in the bankrupt cies of United Airlines and telecom firm Winstar and Teligent. By the time of GM filing, however, many of the compa ny's debt holders may be risk-savvy in vestors like Wilbur L. Ross. Turnaroun whizzes like Ross buy dis tressed debt to get a voic in restructuring plans an then seek an equity stak when a company emerge from bankruptcy.

Stockholders, howeve usually get wiped out. Tha fact may also play a big rol in keeping GM out of bank ruptcy. Even if it wanted t file, billionaire Kirk Kerko rian would do everything t fight the move. His 9.9% stake is already underwater by abou $350 million. Kerkorian and other larg shareholders—many of whom have suf fered longer—could band together an force management to fix the busines without bankruptcy. One source familia with Kerkorian's tactics says he wants t see a deep restructuring plan done quick ly, and outside of the courts.

That would be the best for all con cerned, so long as the company faces u to the enormity of its current mess an executes a plan that finally stands chance of working. ■

–With Michael Orey an Michael J. Mandel in New Yor

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PLASTIC

PREPAID CARDS: CANDY FOR CRIMINALS?

Law enforcement officials say they're ready tools for thieves, drug rings—even terrorists

BY CHESTER DAWSON

IT'S THE HOLIDAY SEASON, WHICH means that many shoppers will solve their gift-giving dilemmas by buying prepaid gift cards from retailers such as Neiman Marcus and Starbucks. But there is a darker aspect to the prepaid card boom, which involves a new kind of card that can be used almost anywhere—including ATMs worldwide.

Law enforcement officials say these newer cards, many of which can be reloaded online or at check out counters, are an ideal tool for credit-card thieves, drug rings, and even terrorist cells. "It is a great concern to DEA and the FBI because of the terrorist financing angle," says Don Semesky, chief of the office of financial operations at the Drug Enforcement Administration.

Prepaid cards have grown rapidly into a $63.4 billion business. There are two kinds. So-called closed-system cards can be used only at the retailers that issue them. The newer open-system cards, in contrast, can be used at almost any retailer. Better yet, you can use many as ATM cards and withdraw the amount you put on the card anywhere in the world. Sunoco, Rite Aid, and Safeway, among others, all sell these open-system cards, and will replenish them as well.

Most of the open-system cards sport MasterCard or Visa logos: Their networks provide the ATM privileges the cards enjoy. "It's the first blending of a bank and nonbank product," says Patrice Motz, a special counsel at Washington law firm Bryan Cave LLP and a former official at the Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury Dept.

That bank/nonbank link is the key to the problem, since the cards have ATM privileges but are not linked to personal bank accounts, which are closely monitored. "It's a very easy way to launder money," says Larry D. Johnson, head of the Secret Service's criminal investigative unit. Cards are easier to smuggle than cash across the border. Although at some point purchasers are supposed to provide basic identification to vendors of the cards, in reality it can be hard to trace ownership. "This is not just an issue in the U.S., but throughout the global financial community," says Daniel Glaser, deputy assistant secretary for Terrorist Financing & Fina cial Crimes in the Treasury Dept.

Law enforcement officials have not prosecuted many cases involving prepa cards, but they see the impact already. one case this year, a Mexican crimin caught at the border used stolen cre cards to transfer funds onto prepa cards. And U.S. police in the Southw have noted clear changes in mon movements across the border, where th closely track suspicious wire transfe The number of dodgy transfers is dryi up. "The dollar numbers that we're loo ing at are declining dramatically," sa Arizona Assistant Attorney Gener Cameron H. Holmes. "The use of store value cards is, if not the main reason, least one reason they are able to esca our scrutiny."

OUTSIDE THE LAW

ORGANIZED CRIMINALS further avo detection by "smurfing," or breakin down large amounts of cash into small sums that are then loaded on to many di ferent cards. The industry, though, clain that law enforcement officials are ove stating the threat. "The perception is ve different from the reality," says Rhond Bentz, a Visa USA vice-president charge of public affairs. "We have man sophisticated fraud systems in place."

Officials counter that such transactio need even more scrutiny, since they fa outside the purview of federal statutes, in cluding most money-laundering law and some provisions of the Patriot Act 2001, that govern banks and other finan cial institutions. "In a cash-based worl we had built up a world of controlle monitoring," says Carol R. Van Cleef, money-laundering expert and partner a Bryan Cave. "Those laws have not bee revised for the very nev world we are in today."

The bigger question i whether these cards ca be used for far mor frightening purposes. A internal U.S. Treasur report notes that th September 11 hijacker were later identified b their bank accounts, car signatures, and wir transfers. "Had the ter rorists used prepai cards to cover their ex penses, none of these fi nancial footprints woul have been available," th report said. A chilling thought. ■

THE STAT

$257 Billion*

Projected value of transactions via prepaid cards by 2009, up from $63.4 billion

*Both open- and closed-systems

Data: Aite Group

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SOFTWARE

NORTON GETS A BIT LESS SECURE

Hacker attacks on its antivirus software could hurt Symantec's premium brand

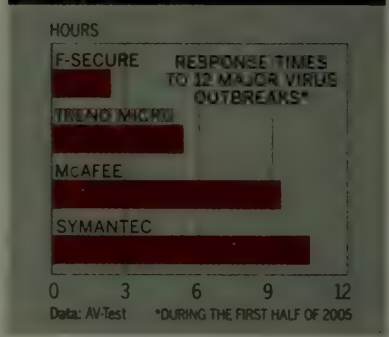
BY SARAH LACY

WHAT'S THE NEWest security threat lurking on your PC? It's not the spam sitting in your inbox luring you to fake Web sites. Or the keystroke-logging malware recording your passwords. It's holes in the software designed to protect you from all that. It's true: Hackers, bored with attacking Microsoft, are going after Symantec Corp., whose Norton products are the first line of defense on 50 million PCs worldwide. Says Ralph R. Echemendia, an info-tech security instructor at Vigilar's Intense School, a Ft. Lauderdale security training institute: "They've become a new target."

THOMPSON Rivals are an increasing threat, too

That's bad news for a company trying to differentiate itself from rivals—including Microsoft Corp., which rolled out two security products on Nov. 29—by positioning itself as a premium brand that charges top dollar. "The danger is you turn off consumers," says Andrew Jaquith of market researcher Yankee Group.

RANKING THE VIRUS HUNTERS



How big is the threat to Symantec and its customers? Already, hackers are bypassing or disabling Symantec software in their efforts to access personal information or spread viruses and worms. And there's mounting evidence that hackers are trying to use Symantec software as an actual gateway into corporate servers and PCs. A Nov. 22 report by the SANS Institute, a computer-security watchdog, showed a tenfold increase in attempts to exploit a flaw in a Symantec data-protection program after it was disclosed in May.

Symantec's ubiquity—a 64% share of the consumer antivirus market—has made it a prime target. By contrast, rival McAfee Inc., with just 15.7% of the market, according to IDC Research Inc., is experiencing fewer attacks. At the same time, hackers are becoming increasingly sophisticated. Exhibit A: Golden Hacker Defender Forever, Web-based software that promises to cloak any malicious code so that it won't be found by leading antivirus packages. For an extra $125, hackers can even buy "antivirus support," regular updates to the cloaking code designed to stay one step ahead of similar hacker-fighting updates put out by Symantec and others.

Symantec contends it has the wherewithal to take on the hackers. The company has more than 100 researche combing cyberspace to figure out whe hackers are going next and how to prote its customers. "The issue is, when a vu nerability [is found], how quickly do yo respond?" says Symantec Chairman an CEO John W. Thompson. "If by son quirk of fate we discover a problem, lil firefighters we move quickly to addre it." Symantec sends out patches within 2 hours of a vulnerability being expose which compares favorably with an ave age of 51 days for most software firms.

A MATTER OF HOURS

BUT IN A WORLD of industrial-scale hack ing, that might not be fast enough. Accord ing to AV-Test.org, a Germa virus tracker, Symantec's averag response time for the 12 majo virus outbreaks during the firs half of 2005 was 10 hours, 4 minutes. McAfee scored slightl better with 9 hours, 29 minutes F-Secure Corp., a Finnish securit firm, took 2 hours, 37 minutes. "[A few hours] make a world of differ ence," says F-Secure President an Chief Executive Risto Siilasmaa "Viruses infect PCs exponentially."

The threat arrives at a tim when Symantec is under un precedented pressure. Whil the company continues to sel most of its consumer product through computer stores, lat last year McAfee and other ri vals began distributing thei software through Internet service providers, which give it to subscribers for free. Microsoft's entry into the market is sure to up the price pressure. In an attempt to diversify beyond the increasingly competitive security business, Symantec a year ago bought storage-software maker Veritas. But many investors viewed the $10 billion acquisition as an awkward fit. That perception, and the company's warning on Nov. 1 that revenues in fiscal '06 would be lower than expected, have battered the stock, which, at about $18, is 47% off its 52-week high.

CEO Thompson vows not to be drawn into a price war. Let McAfee target customers lacking even the most basic antivirus software, he says. Symantec is focusing on a more sophisticated suite of security products with fatter margins. But customers will only keep paying up if Symantec is seen as the premier brand. If hackers continue their onslaught, security vulnerabilities could be the least of Thompson's problems. ■

–With Brian Grow in Atlanta

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WEB SHOPPING

E-TAILERS TRY NEW HOLIDAY TRICKS

They're tapping blogs, social-networking sites, and GPS technology to lure shoppers

BY TIMOTHY J. MULLANEY

DARCEY HOWARD needed an idea. The Seattle image consultant wanted to find a business gift she could give clients—something stylish, yet appropriate for more than one person. So she went to Judysbook.com, a social-networking site that lets people stay in touch with friends or business associates, and asked for input from the members of her network, mostly other marketing pros. They recommended the Dangle, a $35 portable handbag holder that sits on a tabletop, letting women avoid plopping their Coach and Gucci bags on the floor. Howard was sold—on the Dangle and on using the Net for smarter shopping. "You can spend a lot of time there, reading things and finding stuff," she says.

It's not only a merry Christmas on the Web this year, it's also an innovative one. Forrester Research Inc. says online retail sales this holiday will surge 25%, to $18 billion. The increasingly strong profitability of Net commerce is giving retailers the chance to experiment with a stockingful of new sales and marketing tactics. They're tapping into technologies such as blogs, social networking, and wireless phones to draw shoppers to their sites. "There are a host of new ways to reach out that are more innovative," says Forrester analyst Carrie Johnson.

The experiments are coming from startups to Web giants alike. Yahoo! Inc. is testing Shoposphere, a networking site within Yahoo! Shopping that offers thousands of reviews, blogs, and shopping lists generated by members. Rob Solomon, a vice-president at Yahoo! Shopping, says relying on users lets Yahoo serve markets too small to command space on its front pages. An example: One member's "Poker Night" shopping list, which tells readers where to find 16 must-haves, from strategy books to green, felt-covered tables. "If you can tap into expertise like that, it's really special," Solomon says.

It can also pay off for smart shoppers. Yub.com, a site with thousands of product reviews, offers visitors cash-back rewards of up to 10% when they make purchases at more than 60 other sites, including Macy's and cosmetics retailer Sephora. Yahoo plans to let people earn cash for posting reviews that lead other users to make purchases.

Sometimes the experiments aren't about closing sales online but about fin ing new ways to market to harried ho day shoppers. Blog DailyCandy.com o fers fashion and beauty tips to the you and hip in eight cities. This fall launched a newsletter alerting membe to deals in their areas. Now compani from Apple Computer Inc. to Levi Strau & Co. are lining up to be included in t online mailing, offering DailyCan members discounts of up to 25%.

Perhaps the biggest potential lies ventures that want to tie e-commerce to l cal commerce, which still accounts f about 95% of retail sales. Drawing most the attention is Google Base, a databa service from Google Inc. that lets peop and businesses advertise almo any product or service in a city region. Already, 14.5 million pro ucts are listed on Google Base.

SHOP AROUND THE CORNER

THE SEARCH GIANT is but one many players in the field, howeve Startup Cairo.com rounds up loc advertising circulars and pu them online to let shoppers kno which physical stores in their are offer the best sales. ShopLocal LL has the same sort of circular info mation on its site, plus what claims is the first service for com paring prices at online retaile with those of local merchant ShopLocal Chief Marketing Off cer Dave Hamel says the site ha prices from as many as 700 loc stores in some cities.

New York's GPShopper Inc. with its S'Lifter service, has at tracted attention from retailers a large as Foot Locker Inc. S'Lifte lets people use their cell phones t compare prices at nearby store and get notices of local sales. By next year the company plans to let consumers fil out wish lists, then use satellite technolo gy to flag them when they walk past a store that has one of the items on sale "We want to find out how many of these places are being used by our customers," says Raul Vasquez, vice-president fo marketing at Wal-Mart.com. "We'll work with several of them."

No one pretends to know how much business the new technologies can help Web merchants capture. Still, the experimentation this season is striking, after years when what passed for innovation was bigger pictures of products. The changes are starting small. But if they work, look for a lot more like them for Christmas 2006 and beyond. ■

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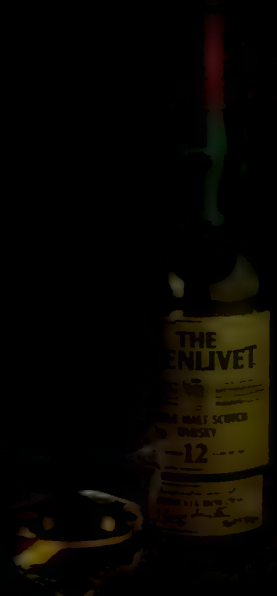

The single malt that started it all.

DITED BY RICHARD S. DUNHAM

Eyeing a Tax on Company Benefits

ITH MUCH OF HIS 2005 DOMESTIC AGENDA in the deep freeze, Presdent Bush is in the market for big ideas. And *BusinessWeek* as learned that Bush is seriously considering one that could ead to profound changes in the way businesses provide health nsurance for their employees. The plan would, for the first time, rb the generous tax breaks that emoyees get with their company-paid edical coverage. It's a sweeping move at could affect almost every business nd give the President a bold, if controersial, reform initiative for his State of e Union address in January.

Bush sees a cap on the health-care tax bsidies as one way to rein in soaring edical costs, give people more control ver their insurance, and generate new evenues. And many experts like the idea. ut messing with employer-sponsored are runs a huge political risk. Mere talk f such an option is already uniting busiess and labor in opposition. "Let's call it vhat it is: a proposal to tax benefits," says lobbyist for the U.S. Chamber of Comerce. Unions are preparing to paint any uch plan as "Son of Social Security Reorm," another assault on the safety net.

Currently, two-thirds of Americans unler 65 get health coverage on the job. Employers pay more than 70% of the cost of hose policies, and thanks to Uncle Sam, vorkers get the benefit tax-free. That will ave insured employees a staggering $126 illion in taxes this year.

In an effort to change that, Administraion aides are looking closely at a proposal hat didn't receive much attention when Bush's tax reform commission suggested it n early November. The idea: If workers reeive high-cost health insurnce paid by their employer, hey should be taxed on part f the value of those benefits. Curbing tax breaks is "a senible start," says Massachuetts Institute of Technology economist Jonathan Gruber. And it won't take that long efore it actually starts to ave some bite."

Today the average family olicy costs about $10,800. Under the plan being eyed by the Administration, employees could still get $11,500 in family coverage tax-free. But if their insurance is more generous, they would have to pay taxes on the difference. That could add several hundred dollars to the taxes of high-end executives and union members with generous health packages, such as teachers, firefighters, and police.

BUSH Looking for an antidote to spiraling health costs

Backers of the idea say that taxpayers shouldn't subsidize gold-plated policies. They argue that patients with such Cadillac plans have little incentive to shop for efficient care, buy generic drugs, or question whether they need yet another expensive test.

What's more, the benefits of such tax breaks are overwhelmingly tilted toward wealthier workers. Because the value of deductions rises with tax brackets, high-income families get a third of their costs covered by Uncle Sam. Working-class families get only a 10% subsidy.

Even before the plan is fully hatched, corporate lobbyists have begun raising objections in meetings with Administration staffers. At the same time, companies and unions have begun to line up opposition on Capitol Hill. AFL-CIO health lobbyist Gerald M. Shea says that fighting the cap could top labor's 2006 legislative agenda.

Bush is considering a tax on gold-plated company health plans

FODDER FOR THE DEMS

UNIONS WORRY THAT limiting tax breaks for insurance would accelerate the loss of workers' health benefits—already under siege as companies seek to curb soaring costs. And as much as chief executives dream of getting out of the business of offering health insurance, many large employers fear that the alternative to workplace coverage would be a big government program that they would end up paying for through higher taxes.

Bush may try to calm the business community by letting workers use pretax dollars to buy their own insurance. Indeed, the President has been talking for years about giving a tax credit to people who purchase policies on their own rather than through their job. But Bush has more will than wallet, and the tax benefits are too small to jump-start the full-blown market for individual insurance that he favors.

With business and labor opposed, any proposal will face a tough fight on Capitol Hill. Republicans already worry that an unpopular President could cost them control of Congress in 2006. Now, they fear, the health plan could fuel Democratic demagoguery along these lines: "Last year, he tried to take your Social Security. This year, he's after your health care." But that might not stop a President known for rolling the political dice from pushing a plan he believes is good public policy. ■

—By Howard Gleckman and Rich Miller

FRONTIERS

THE RISE OF CENTRAL EUROPE

Deep reserves of educated, ambitious, and affordable workers are driving the region

BY JACK EWING AND GAIL EDMONDSON

THEY CAME FROM AROUND the world, young men with handles like SnapDragon and Bladerunner attacking computing problems so complex that even experienced coders could only stare at the screen in bewilderment. Only one mastered the final algorithm problem: Eryk Kopczynski, a.k.a. Eryx, a Warsaw University student who wears his long hair in a ponytail and says his life's ambition is to "discover some interesting notion."

Kopczynski's triumph in this year's TopCoder Open, sponsored by Sun Microsystems Inc., was no fluke. He was following in the footsteps of a slew of computing geniuses to emerge from the monolithic Soviet-style buildings of Warsaw U. "Poles like to compete," says computer science student Marek Cygan, winner of this year's Google Code Jam. No kidding. Warsaw U. is ranked No. 1 in the world in top coder events, ahead of Massachusetts Institute of Technology.

READY TO ROLL Employees of London-based LogicaCMG in talent-rich Prague

How Central Europe's Workers Stack Up

HOURLY WAGE, BY PROFESSION

COUNTRY	FACTORY WORKER	ENGINEER	ACCOUNTANT	MIDDLE MANAGER
Poland	$3.07	$4.32	$4.03	$6.69
Czech Republic	2.81	5.38	4.10	6.81
Hungary	1.96	5.09	4.62	7.44
Slovakia	2.21	4.15	3.37	5.48
Romania	1.41	2.58	1.23	3.23
Bulgaria	0.73	1.43	0.83	2.80
China	0.80	3.50	3.20	4.42
India	0.43	2.40	1.93	3.13
Germany	18.80	38.90	26.40	40.40

Data: Compiled by Ariba Inc. using national sources

Just like India's best tech schools, Warsaw U. has confounded a scarcity of resources to identify and nurture bright students.

As the race for talent heats up globally, it turns out that Central Europe houses one of the planet's richest creative pools. U.S. movie director Brian De Palma, on location in Sofia, recently wrapped up filming of *The Black Dahlia*, a version of the James Ellroy noir novel starring Hilary Swank and Scarlett Johansson. The producers painstakingly recreated the streets of 1940s Los Angeles on a Sofia movie set. Why Bulgaria? Superlow costs is one reason. Here's another: "The crew is probably the best I've seen anywhere," says David Varod, head of Bulgarian operations for Los Angeles-based Nu Image/Millenium Films, which produced the picture.

Next stop on the tour: a Budapest neighborhood where new office buildings encroach on older factories. Here outsourcer Genpact, a spin-off of mighty General Electric Co., employs 550 workers to handle business processes such as accounts receivable for corporate clients. At one terminal, a young woman uses SAP software to process an invoice from a German supplier to a French company. It's cheaper to do such work in India: Gross pay for Genpact workers in Budapest ranges from about $950 to $1,400 a month, four times the Indian pay scale. But it would be very difficult to find French-speaking Indians to do the job. For some clients proximity is key. Says David Morgenstern, a managing director at Sunnyvale (Calif.) supply-chain specialist Ariba Inc.: "Even if China is 5% cheaper, that sways the argument back to sourcing in Central Europe."

It has been more than 15 years since the collapse of the Iron Curtain opened up Central Europe to the world. In that time the region's 10 countries have survived bouts of gangster capitalism, waves of painful reforms, and dramatic changes in government. Yet these economies have somehow managed to thrive, easing entry (for most) into the European Union. In the process, Central Europe has made a wholesale transformation into the low-cost manufacturing zone of the continent.

INVESTMENT MAGNET

TODAY THE REGION is sucking in foreign investment at a rate of $37 billion annually, which places it second to China in the international competition for capital and light years ahead of India. Central European stock markets are taking off, too. Growth ranges from 3.5% in Poland to 6.8% in Estonia. Poverty rates are declining, and the area's 100 million citizens are turning into a potent consumer market. Most of the region's countries have flat taxes, with rates as low as 15% for corporations—a big investment draw. Multinationals, from Hewlett-Packard to SAP to GE, have been piling in. On Sept. 21, IBM announced plans to build a new software development lab in Krakow.

What few anticipated is that these once-bankrupt economies would move up the industrial food chain so quickly and attract research jobs in knowledge-driven industries. Now, thanks to their growing ranks of high-skilled workers, these countries are shaping up as the next outsourcing haven, just behind China and India. In offices above an Audi dealership in Sofia, for instance, engineers working for Idaho-based AMI Semiconductor Inc. are busy developing

next-generation chips for automobiles and medical equipment. AMIS set up an office in the Bulgarian capital after its managers in Belgium noticed they were getting a lot of applications from qualified Bulgarians. Anelia Mladenova Pergoot, a native Bulgarian, came home to run the new office, which plans to double staff, to 40, by next year. "I'm impressed by the quality the technical universities have been able to support," she says.

R&D ON THE RISE

IN THE CZECH REPUBLIC, investments in such sectors as software and customer service centers rose 150% in 2004. According to IBM, Hungary, Poland, and the Czech Republic ranked among the top 10 global destinations for research and development jobs in the first half of 2005. In Europe, only Britain attracted more R&D work. Some 67% of the Polish economy is already made up of services, says the Organization of Economic Cooperation & Development. Case in point: Hewlett-Packard Co.'s five-year-old information-technology outsourcing center in Warsaw, which employs 1,000, and its new $54 million business-process outsourcing center in Wroclaw, which is expected to create another 1,000 jobs. HP already generates $550 million in revenues in Poland.

To develop these service businesses, the multinationals are finding talent in the region's top schools. Poland boasts one of the highest percentages of university graduates in the world among younger workers. The country mints 460,000 new grads each year.

Problems? There are plenty, of course, just as there are in India and China. Central Europe's top cities boast state-of-the-art infrastructure, but second-tier cities and the countryside are another story. Management talent, as opposed to technical and manufacturing knowhow, is scarce. Judicial corruption is still a big problem in Romania, and the mob remains dangerously active in Bulgaria.

Still, considering what the region endured through 40 years of communism and a decade of tumultuous transition, these problems look manageable. Today, Central Europeans have an optimism that few in Western Europe can muster. Local companies are bulking up and beginning to buy foreign rivals. MBA programs are mushrooming. And thirtysomething managers are running big businesses—even entire economies. That energy and drive is personified by Janos Koka, 33, who was president of an Internet service provider before becoming Hungary's Minister of Economy & Transport in 2004. "We are in the middle of everything," Koka boasts. Hungary was ranked third worldwide on a per capita basis, behind New Zealand and India and ahead of the U.S., in the number of people launching businesses by the German Institute for Economic Research in Berlin.

How did Central Europe gain this momentum? It started with the manufacturing plants coming in

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FLUSH TIMES Turning out American Standard bathroom goods in Sevlievo

MANUFACTURING

Based in New Jersey, Thriving in Bulgaria

Sevlievo, a city of 25,000 tucked into a valley beneath the Balkan range in central Bulgaria, is about the last place you would expect to find a bastion of American enterprise. Battered Russian-made Ladas bump along cratered streets, and soot-stained, concrete high-rise apartment blocks are the prevalent mode of housing.

Yet this is where American Standard, the Piscataway (N.J.) company, does most of its manufacturing of bathroom fixtures and toilet bowls for the European market. Indeed, Sevlievo is very much an American Standard company town, with three factory complexes and 3,700 people on the payroll.

American Standard was a pioneer when it ventured into Sevlievo 12 years ago to take advantage of Bulgaria's low manufacturing wages. Now the country is hot. With European Union membership likely as soon as 2007, Bulgaria has been luring U.S. high-tech companies such as AMI Semiconductor and Tumbleweed Communications Corp., a maker of security software. Both companies want to profit from the nation's well-regarded tech school graduates. Foreign direct investment in Bulgaria more than doubled in 2005, to $2.7 billion, from $1.2 billion.

American Standard has used a simple method to train Bulgarian managers in the ways of free enterprise. Vassil Kanev, former chief of a state-run fixture company that American Standard took over in 1992, shadowed top executives at the company's German unit. Shop-floor supervisors also spent as long as two months working alongside their German counterparts—returning to Bulgaria only when they could operate machines as fast as the Germans. "We knew there was a big difference in skills and technology," says Kanev, who has gone on to become the leader for American Standard's bath-and-kitchen division in Eastern Europe.

There have been challenges, of course. Sevlievo had no gas to fire up the kilns that bake clay forms into shiny white sinks. American Standard solved that problem by helping a Bulgarian utility finance a new pipeline. One fringe benefit: Sevlievo residents can now cook and heat with gas. And that's the least of what residents of Sevlievo have gained. The municipality has near-full employment, and Audis and Opels now mingle with those Ladas on the streets.

American Standard also manufactures in Asia, but Bulgaria remains attractive because of its proximity to fast-growing consumer markets such as Ukraine and Russia. Sevlievo "is very competitive to what we do in Asia," says American Standard Chief Executive Frederic M. Poses. The city has an ample supply of talented scientists and tech school graduates who work for a tenth of U.S. salaries. Foreign companies are increasingly tapping these Bulgarian engineers for advanced design work, in addition to manufacturing. "This is a good environment for setting up a business," says Anelia Mladenova Pergoot, managing director for AMI Semiconductor in Bulgaria. A Balkan tiger? Bulgaria has the potential.

–By Jack Ewing in Sevlievo

THE STAT

119%

Increase in foreign investment in Bulgaria, 2004-2005

Data: European Bank for Reconstruction & Development

from the West. Toyota Motor, Volkswagen, General Motors, PSA Peugeot Citroën, Renault, and Fiat are among those building complete cars in Poland and the former East Bloc. Countries in Central and Eastern Europe also produce everything from Whirlpool washing machines to American Standard bathroom fixtures.

Yet as the manufacturing powers have learned, workers in Central Europe are good for much more than low-cost assembly. The old Marxist regimes supported excellent universities and technical schools, which are still churning out top-notch graduates in engineering, mathematics, and computing.

It took a while for Western companies to seize on this hidden advantage. Hari N. Nair, an executive vice-president of Tenneco Automotive, says his company never planned to hire skilled engineers in Poland. But as they moved low-cost production of auto parts to that country, Tenneco executives realized that Poles on-site were able to handle the engineering. "If you give them advanced tools and design knowhow, they bridge the gap between complex technology and low-cost systems," says Nair.

Now, tech companies are swooping in to snap up this young talent. The Czech capital of Prague has emerged as an info-tech hub, attracting investment from the express delivery and logistics company DHL International or Logica-CMG, a London-based outfit that provides tech services, such as processing text messages for mobile-phone companies. "In France, the prestigious univer-

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sities to go to are management, economics, law. But here, technical schools are also prestigious," explains Jiri Turek, operations director for LogicaCMG's Corporate Global Telecom Products unit.

More companies are also realizing that Central and Eastern Europe are competitive with Asia on price. An engineer in Bulgaria costs his employer less than one in China or India (table, page 51). And competition for top talent is not as intense as in Asia's boomtowns. That's one reason why Tumbleweed Communications Corp., a Redwood City (Calif.) maker of network-security software, chose Sofia over Bangalore for its 130-person software development center. In Bangalore "it was difficult to get the right people at a reasonable cost when you have Microsoft across the street," says Eric Dumas, Bulgaria country manager for Tumbleweed.

Central Europe's boom may turn out to be a long one

What ultimately sets Central Europe apart, though, is its drive. Poles work an average of 1,984 hours a year, above the 1,777 hours clocked by U.S. workers on average and far more than the 1,362 hours Germans work, according to the OECD. "These people work day and night," says Stefaan Vandevelde, managing director at Delphi Europe, which has two engineering centers in the region.

How sustainable is this growth story? All the elements are there: pent-up demand, robust foreign direct investment, excellent universities, and improving infrastructure. The region is still relatively free of the labor regulations that stifle job growth in Germany, France, and Italy. What's more, even by 2020 wages in most of the region will still be one-third to half the EU average, according to the U.N. Conference on Trade & Development.

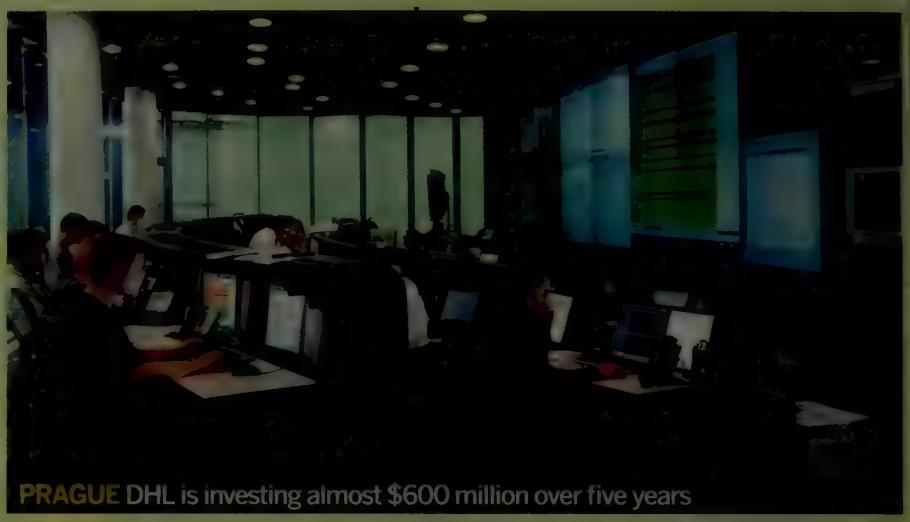
Still, Central Europe can't afford to be complacent. "The big question is how we position ourselves," says Henryka Bochniarz, former Minister of Industry in Poland and founder of a Warsaw consultancy. "We have to build our future based on the quality of our education." Government needs to make sure those algorithmically gifted coders remain a high priority. ■

–With Patricia Kranz in Prague, Andy Reinhardt in Krakow, and bureau reports

BusinessWeek online To learn more about Central Europe, visit us online at www.businessweek.com/extras

FOREIGN INVESTMENT

Sitting Pretty in Prague: DHL's Tech Triumph



PRAGUE DHL is investing almost $600 million over five years

Walk into the network operations center at DHL's IT Services Center in Prague, and the first thing you see is the magnified projection of a computer monitor as big as the screen in your local cineplex. On either side of the screen, which tracks every operation handled by DHL's global network, are two televisions broadcasting news and weather. When you're running a company that ships a billion packages a year, the weather is just as important as monitoring fuel prices. "We got news about the [2004 Asian] tsunami early, thank God," says Richard du Plessis, head of production services.

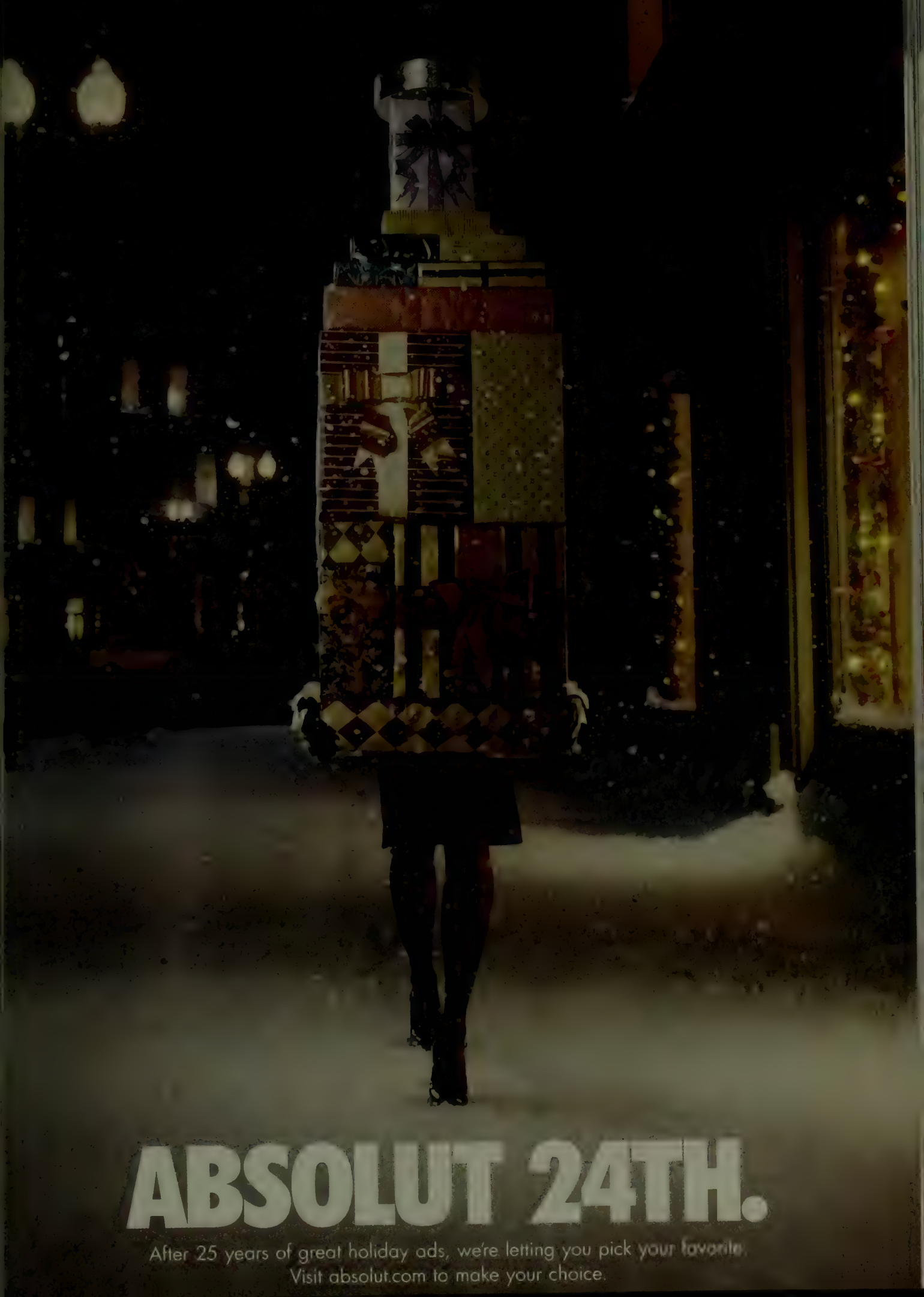
The tsunami could have been a disaster for DHL, which has a network operations center in Cyberjaya, Malaysia, as well as in Prague and Scottsdale, Ariz. Luckily, the Cyberjaya facility was spared. As part of DHL's "follow the sun" policy, Cyberjaya manages the network for eight hours a day. At 10 a.m. Central European Time, Cyberjaya hands off to Prague. Eight hours later, Prague hands off to Scottsdale. That way, the global shipping company can track packages at any hour. "This is not a call center. What we do here is high-end IT," says Stephen McGuckin, Prague-based managing director of IT services.

Prague's pool of highly skilled IT workers was a big reason DHL decided to invest more than $589 million over five years in the IT center. Not only are the city's engineers cheap—the average wage is $23,570—but they also have the experience to do sophisticated work such as designing and building new software. And Prague's lively music and club scene attracts young people from around the world. Three-fourths of DHL's 900 workers are Czechs; the rest are from 46 countries. Other pluses are Prague's air links to the rest of Europe, its good infrastructure, and a business-friendly climate. "We made the decision to come here in 2003, and since then it has become even more desirable," says McGuckin.

In fact, DHL's IT center in the Chodov neighborhood on the outskirts of Prague is the hub of a new tech-services office park. Consulting giant Accenture Ltd. recently opened a branch in an adjoining building, and other U.S. companies are scouting the area. DHL plans to add 600 employees when its second building is ready next year.

Given the Prague facility's importance to DHL's global operations, every precaution has been taken to make the center immune to disaster. "We have two of everything," says du Plessis. The computer network is backed up by a duplicate system about five miles away, and DHL also keeps generators and fuel tanks in an underground chamber that can keep the facility going for five days. DHL has left nothing to chance—and that includes choosing Prague as the site for its European IT center.

–By Patricia Kranz in Prague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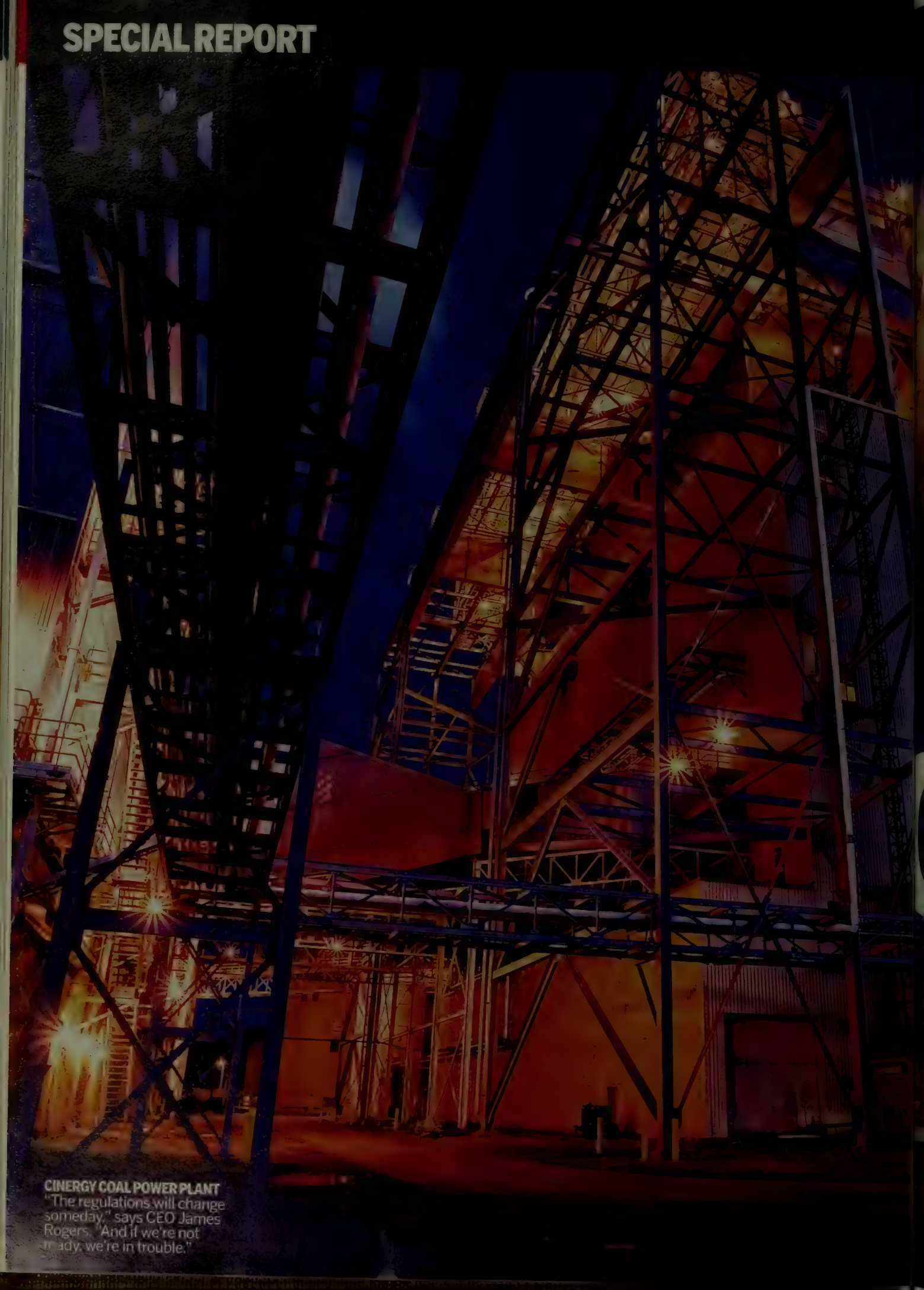


CINERGY COAL POWER PLANT
"The regulations will change someday," says CEO James Rogers. "And if we're not ready, we're in trouble."

BOB HOWER/QUADRANT

The Race Against Climate Change

How top companies are reducing emissions of CO_2 and other greenhouse gases

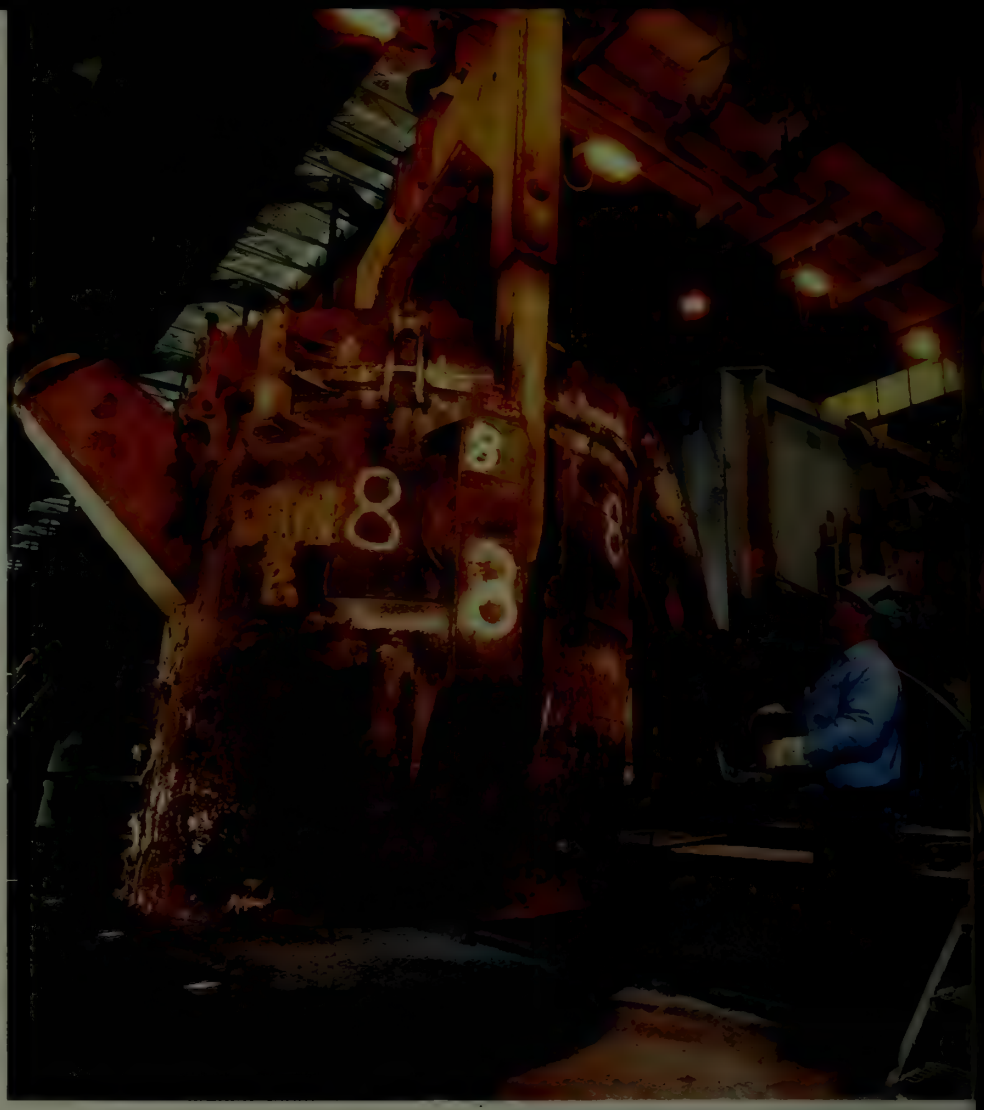
BY ADAM ASTON AND BURT HELM

ON NOV. 21 power company executives from all over the country gathered in the Pit, a spacious General Electric auditorium in Crotonville, N.Y., to meet with GE CEO Jeffrey R. Immelt and his team. The day was overcast and cold, but the discussion was about the warming climate. At one point in the meeting, David J. Slump, GE Energy's chief marketing executive, asked for an informal vote. How many of the 30 or so utility and GE business executives thought that, once President George W. Bush was no longer in office, the U.S. would impose mandatory curbs on the emissions of carbon dioxide and other greenhouse gases linked to global warming? Four out of five of them agreed. "Forget the science debate," says Cinergy Corp. CEO James E. Rogers, who was at the meeting. "The regulations will change someday. And if we're not ready, we're in trouble."

The world is changing faster than anyone expected. Not only is the earth warming, bringing more intense storms and causing Arctic ice to vanish, but the political and policy landscape is being transformed even more dramatically. Already, certain industries are facing mandatory limits on

emissions of carbon dioxide and other greenhouse gases in some of the 129 countries that have signed the Kyoto Protocol. This month representatives of those nations are gathering in Montreal to develop post-Kyoto plans. Meanwhile, U.S. cities and states are rushing to impose their own regulations.

ALCOA By improving the refining process, it cut emissions 25%



A surprising number of companies in old industries such as oil and materials as well as high tech are preparing for this profoundly altered world. They are moving swiftly to measure and slash their greenhouse gas emissions. And they are doing it despite the Bush Administration's opposition to mandatory curbs.

This change isn't being driven by any sudden boardroom conversion to environmentalism. It's all about hard-nosed business calculations. "If we stonewall this thing to five years out, all of a sudden the cost to us and ultimately to our consumers can be gigantic," warns Rogers, who will manage 20 coal-fired power plants if Cinergy's pending merger with Duke Energy is completed next year.

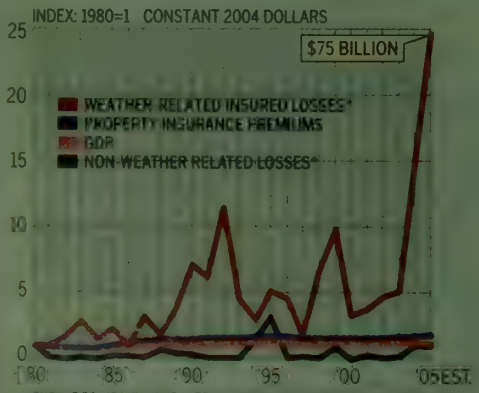
One new twist in the whole discussion of global warming is the arrival of a corps of sharp-penciled financiers. Bankers, insurers, and institutional investors have begun to tally the trillions of dollars in financial risks that climate change poses. They are now demanding that companies in which they hold stakes (or insure) add up risks related to climate change and alter their business plans accordingly. For utilities like Cinergy that could mean switching billions in planned investments from the usual coal-fired power plants to new, cleaner facilities.

The pressure is forcing more players to wrestle with environmental risks, even if the coming regulations aren't right around the corner. As the debate over climate change shifts from scientific data to business-speak such as "efficiency investment" and "material risk," CEOs are

Heating Up

Taxes on greenhouse gas emissions may sound painful and unnecessary, but climate change could be even worse

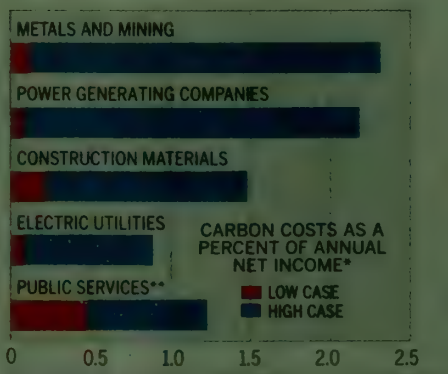
Climate change is already hurting the insurance industry



*EXCLUDES HEALTH AND LIFE INSURANCE PREMIUMS AND LOSSES

Data: Munich Re; NatCatSERVICE; Swiss Re; Sigma; analysis and estimates by Evan Mills, Lawrence Berkeley National Laboratory

If that leads to a carbon tax, these industries will suffer the most



*IN A KYOTO-STYLE SCENARIO: CARBON CREDITS COST $20, EMISSIONS FALL BY 5% OVER 7 YEARS.
**WASTE AND FACILITIES MANAGEMENT SERVICES

Data: Innovest

But if global warming intensifies, more sectors will feel the pain

Hotter Summers
- boost both heat-related deaths in humans and drought damage to crops and livestock
- induce power shortages, blackouts, and business interruptions

More Intense Storms
- damage coastal infrastructure, property, and ecosystems
- intensify the geographical spread and severity of flooding and wind damage

Warmer Winters
- cut water supplies from snow melt and up the likelihood of wildfires
- extend the reach of disease-carrying organisms such as ticks and mosquitoes

Data: Ceres; Harvard Medical School

Top Carbon Cutters

BusinessWeek, the Climate Group, and a panel of judges compiled this ranking, based on companies' total reduction of greenhouse gases, results relative to their size, and the leadership they have shown:

	2004 SALES, BILLION DOLLARS	EMISSIONS REDUCTIONS, METRIC TONS (%)
1. DuPont (U.S.)	$27.5	11 million (72%)
Cut energy use 7% below 1990 levels, saving more than $2 billion—including at least $10 million per year by using renewable sources.		
2. BP (Britain)	$285.1	12.8 million (16%)
Reached its 2010 emissions target in 2001. Saved a total of $650 million through improvements in operating and energy efficiency.		
3. Bayer (Germany)	$36.7	4.9 million (63%)
Boosting energy efficiency avoided $861 million in investments that otherwise would have been required because production grew 22%.		
4. BT (Britain)	$18.5	1.6 million (71%)
Low-carbon and renewable sources provide 98% of BT's British power consumption, saving $1.15 billion. Adding 38% reduction in vehicle emissions almost doubles savings.		
5. Alcoa (U.S.)	$23.5	8.9 million (26%)
Slashed emissions of perfluorocarbon (PFC) gas from smelters by 80%. Expects annual cost savings to reach $100 million next year.		

For the full top 10 list, see businessweek.com/go/carbon

DATA: *BusinessWeek*; the Climate Group; Innovest

suddenly understanding why climate change is important. "It doesn't matter whether carbon emission reductions are mandated or not," explains David Struhs, vice-president of environmental affairs at International Paper Co. "Everything we're doing makes sense to our shareholders and to our board, regardless of what direction the government takes." The nation's biggest paper company, with $25.5 billion in sales, IP has upped its use of wood waste to 20% of its fuel mix, from 13% in 2002. That's cut both net CO_2 output and energy costs.

REALITY DAWNS

ADDING TO THE pressure on CEOs, the public has largely accepted global warming as reality. And as in the case of IP, the economic logic can be compelling. Far from breaking the bank, cutting energy use and greenhouse emissions can actually fatten the bottom line and create new business opportunities, while simultaneously greening up companies' reputations. One company that has hiked its visibility on this changed landscape is GE. It formed a new Ecomagination division last May to offer everything from more efficient locomotives to advanced, low-emitting coal power plants.

Scores of companies have already taken action to fight climate change. Who are the leaders? In this special report, *BusinessWeek* has teamed up with the Climate Group, a British organization that serves as a clearing house for information on carbon reduction, and Innovest Strategic Value Advisors, a leading Wall Street green investment research firm. Together with a panel of expert judges drawn from academic institutions, we have identified and ranked the companies that have shown the greatest initiative in cutting their greenhouse gas emissions. We have also identified best practices, effective policies, and what kinds of results to expect.

Details about how the judges made their selections and a wealth of material on the companies and individuals in the rankings can be found at businessweek.com/go/carbon. The lists feature some gold-plated names: Citigroup is working with Fannie Mae to encourage sales of energy-efficient homes. IBM saved hundreds of millions of dollars by cutting energy use, while Unilever managed to slash its greenhouse gas output by more than 10% in a single year.

Topping the company ranking is an experienced hand at making the most out of changing regulations, DuPont. Back in the mid-1980s, DuPont created a profitable business selling substitutes for chlorofluorocarbon (CFC) refrigerants that were destroying the earth's protective ozone layer. Tackling climate change was a natural extension of that experience. After studying the data, "we came to the conclusion that the science was compelling and that action should be taken," says DuPont Chairman and CEO Charles O. "Chad" Holliday Jr.

BEATING GOALS

IN 1994, DUPONT committed to cutting its gas emissions by 40% by the year 2000 from its 1990 levels. By 2000 the company had met its original target and set an even more ambitious one—a 65% reduction by 2010. But the gains have been so dramatic that DuPont has already hit that goal too. It also uses 7% less energy than it did in 1990, despite producing 30% more goods. That has saved $2 billion.

Saving money and reducing risks are both powerful incentives, and they help explain why investors and insurers are pressuring CEOs to tackle climate change. Insurers in particular are staggered by their mounting bills for hurricanes, floods, fires, hailstorms, disease, heat waves, and crop loss. Many scientists agree that higher temperatures are causing more powerful storms and perhaps intensifying extreme weather events, ranging from drought and wild fires to ice storms.

Even tiny weather changes bring awesome costs. A slight uptick in intense storm activity could boost annual wind-

More on the race to cut emissions...

Complete Rankings: The top companies, financiers, political leaders, and regions that are cutting emissions

Unlikely Environmentalist: Why Cinergy's Jim Rogers, who runs nine coal-fired plants, is pushing for carbon limits

Methodology: Our judges, and how they made their picks

Plus: The top 50 CO_2 emitters...Toyota's carbon-cutting efforts

BusinessWeek online

http://www.businessweek.com/go/carbon

related insured losses, to as much as $150 billion a year—an increase equivalent to two or three Hurricane Andrews in an average season, according to a 2005 study by the Association of British Insurers. Indeed, insured losses from catastrophic weather events have already increased fifteenfold in the past 30 years. "Risk of climate change is real. It's here. It's affecting our business today," says John Coomber, CEO of insurer Swiss Re.

Rising temperatures aren't the only factor in the increasing toll from weather-related disasters, of course. Development along coastlines and other high-vulnerability areas is surging, concedes Evan Mills, an energy scientist at the U.S. Energy Dept.'s Lawrence Berkeley National Laboratory. But overall, "weather-related losses are becoming more erratic and growing much faster than such shifts can explain," he says.

The insurance exposure extends beyond weather events to management decisions. Corporate directors and officers are protected from personal liability for mismanagement by so-called D&O policies. If executives at companies that hold the policies don't take stock of their environmental risk exposure, they could be on the firing line for mismanagement—with insurers picking up the tab. Says Chris Walker, managing director of Swiss Re's Greenhouse Gas Risk Solutions: "Property. Life. Health. Crops. D&O—you name it. It's the perfect storm for insurers."

That's why climate change is causing insurance companies to ally with institutional investors, banks, and rating agencies. Together they are pushing companies to start thinking about greenhouse emissions as a material risk, just like other forms of financial risk that can impair future earnings. JPMorgan Chase & Co., for instance, is helping analysts and bankers model the impact of carbon on the banks' clients. "Global warming is on the radar screen of a lot of financial institutions," said Denise Furey, senior director of Fitch Ratings Ltd., at a recent climate conference.

The specter of new regulations on carbon emissions has already galvanized executives at Alcoa Inc., another company on the *BusinessWeek*/Climate Group list. To reduce its greenhouse emissions and save energy, too, Alcoa improved a key step in the aluminum production process, helping to cut total greenhouse gas output by 25%.

A handful of big coal burners have also leaped to the forefront. American Electric Power, Cinergy, and TXU all did detailed studies of the risks posed by climate change—and by expected new rules. Their biggest challenge: planning new power plants for an uncertain future. At some point in the next 40 years—the operating life of a plant—the U.S. is certain to join in a round of international greenhouse discussions, says Michael G. Morris, CEO of AEP, the nation's biggest coal consumer: "That's clear in my mind, and in our board's mind." If the U.S. rules are similar to Europe's, where it already costs a company more than $20 to release a ton of CO_2, utilities and rate payers could face billions in expenses.

That would force utilities to invest more in lower-carbon alternatives such as wind power, "clean" coal, or natural gas, which emits one-third as much carbon per kilowatt as coal. But executives need to know soon what rules they will have to meet. That's why many are in favor of mandatory limits—though they hesitate to say it publicly because of the opposition in Washington.

ISOLATED

THE PRESIDENT remains opposed to any policy that would require carbon cutbacks. Instead, the White House asserts that climate change can be tackled with voluntary action and with major investments in alternatives to fossil fuels, such as hydrogen.

Yet the White House is growing increasingly isolated. U.S. public opinion is shifting. In October, a Fox News poll found that 77% of Americans believe global warming is happening, and of those, 76% say it's at least partly due to human activity. That's making greenhouse gas reductions trendy: The 2006 Super Bowl in Detroit, for one, aims to offset all of the new CO_2 the championship generates by planting thousands of trees in the hills and towns near Ford Field.

More substantively, states are stepping into the breach with their own regulations. Nine Northeastern and Mid-Atlantic states have formed the Regional Greenhouse Gas Initiative (RGGI). By 2009 the initiative aims to set up a "cap-

Green Leaders

A handful of people stand out for their efforts to cut gases that cause global warming

Tony Blair
British Prime Minister

Raised awareness of global warming at the G-8—and tangled with the U.S. on its position. He was also the first leader to go beyond Kyoto's targets—which call for sub-10% cuts by 2012—and pledge a 60% cut by 2050.

Franzjosef Schafhausen
German Ministry of the Environment

Helped Germany exceed its Kyoto obligation. Today greenhouse gas emissions are 19% lower than in 1990. In the process, he has helped to cut Germany's high jobless rate by creating 450,000 new jobs in renewable-energy industries.

John Browne
BP Chairman and CEO

Shocked the oil industry in 1997 when he declared that by 2010 BP would reduce emissions 10% below 1990 levels. That was six months before negotiations on the Kyoto accord began in earnest. BP has since reaped huge profits while transforming its traditional big-oil culture.

Arnold Schwarzenegger
Governor of California

Issued an order that requires California to slash gases by 80% by 2050—the toughest state target of all. He is also backing a plan to cut total tailpipe emissions by one-third by the 2016 model year.

Zhao Hang
President of China Auto Tech & Research Center

Believes China must grapple with global warming. Working with foreign advisers, he devised fuel-economy rules 20% tougher than those in the U.S. By 2030, 300 million cars will be on China's roads—10 times today's number.

For a full ranking, go to businessweek.com/go/carbon

DATA: *BusinessWeek*; the Climate Group; Innovest

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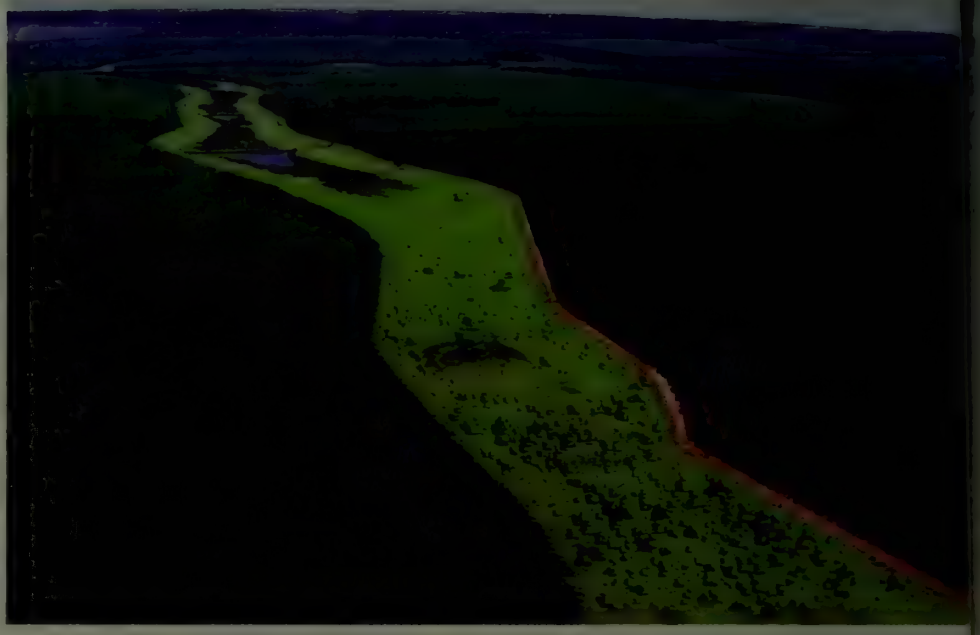
and-trade program" covering carbon dioxide emissions by nearly 200 power plants operating in Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont. Companies would be given an upper limit on greenhouse gases they may release. If they can cut their emissions below that level, they can sell the unused allowances to companies that are emitting above their cap level.

This initiative could bring a major change in the politics of global warming. First, state action will compel more companies to seek nationwide regulation from Congress, explains Eileen Claussen, president of the Pew Center on Global Climate Change. "Companies don't want to see a patchwork of state regulations. As more states get involved, it ups the ante."

Plus, two likely candidates for the 2008 Republican Presidential nomination are on board. New York Governor George E. Pataki launched the regional initiative in 2003, and Massachusetts Governor Mitt Romney backs it in principle.

Meanwhile in Washington, the Republican-led Congress is opposing the Administration's hard line. On June 22, over the objections of the White House, the Senate voted 54-43 for a resolution calling on Congress to "enact a comprehensive and effective national program of mandatory market-based limits and incentives on emissions of greenhouse gases."



TREES FOR FUEL Wood waste now supplies 20% of International Paper's energy

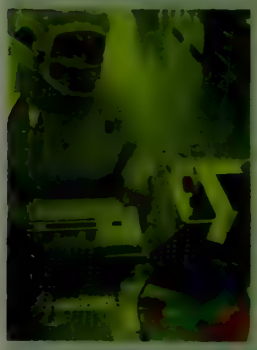
Some evangelical Christian groups, traditional allies of the Bush White House, have joined the call for action. "This used to be seen as just the passion of a few environmentalists on the left," says Jim Jewell of the National Association of Evangelicals, which includes 52 denominations serving 30 million parishioners. "But support on the issue has broadened. God's call on his people is to care for his creation."

In the battle in the nation's capital, it will help that some people believe God is on the side of greenhouse gas reductions. For most business executives, though,

PLAYBOOK: BEST-PRACTICE IDEAS

Green Culture, Clean Strategies

Each company faces special challenges in cutting carbon, but top achievers use similar strategies



CEOs Don't Just Delegate

Pasquale Pistorio, former CEO of STMicroelectronics, believed environmental initiatives in making chips should come from the top—and he passed that commitment along to his successor, Carlo Bozotti. At BP, CEO John Browne works in the trenches with environmental specialists from all business segments. Iberdrola's top gun, Ignacio Sánchez Galán, oversees the Emission Allowances Working Group, which devises ways to fulfill the Kyoto Protocol's requirements.

Green Achievements Count in Performance Reviews

Achieving targets designed to thwart climate change is a major element in senior executives' performance scorecards at Novo Nordisk. Dow Chemical's new Climate Change & Energy Strategy Board is populated by senior executives, who coordinate the work of expert teams responsible for regional strategy, site emissions, and energy conservation.

Operating Units Clean Up

Each Scottish Power division has a senior manager accountable for complying with energy and environment objectives. BHP Billiton has developed greenhouse gas curtailment plans tailored to each of its business sites. BP's operating units field a small army of influential managers for environmental technology, product emissions, and energy efficiency.

Financiers See Dividends

HSBC, led by CEO Stephen Green (right), pledged to offset its entire carbon output by 2006 and hit its goal ahead of schedule. At ABN Amro, new businesses include climate risk management and trading emission allowances. In assessing mortgages, Citigroup rewards borrowers buying energy-saving homes. And JPMorgan Chase is evaluating the impact of carbon on loans to big emitters.

For detailed listings of top governance practices and innovators in financial services, go to businessweek.com/go/carbon

DATA: *BusinessWeek*; the Climate Group; Innovest

MY MONEY KEEPS ME UP AT NIGHT.
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the real driver is the bottom line. Often, the best way to slash emissions is simply to reduce energy consumption. Because carbon is basically a proxy for fossil energy, cutting carbon equals cutting costs, argues energy guru Amory B. Lovins, head of the Rocky Mountain Institute (RMI), a nonprofit energy and environment policy think tank: "Efficiency is cheaper than fuel."

That approach is what landed Geneva's STMicroelectronics, the world's No. 6 chipmaker, on the *BusinessWeek*/Climate Group ranking. Lovins and the RMI helped cut the company's energy use by 5% per year. Many changes were surprisingly low-tech, such as putting in larger air-conditioner ducts. That enabled air-circulating fans to do their job at half speed, using just a seventh of the energy. Last year, with $40 million in improvements, the company saved $173 million.

When mandatory regulations are issued they essentially put a price tag on carbon emissions. That obviously makes cleaner, more efficient projects more financially attractive, spurring new business opportunities. GE, for one, is seizing the moment with its new Ecomagination division. And scores of small companies are bringing new clean-technology innovations to market. Massachusetts Institute of Technology chemical engineer Isaac Berzin started GreenFuel Technologies Corp. to harness the power of algae to grab CO_2 from the exhaust of a gas-fired power plant. At a pilot site atop MIT's on-campus power station, the GreenFuel device cuts CO_2 by 82% on sunny days and by 50% on overcast days.

How far can this effort go? Some economists say cutting emissions and boosting efficiency will spur economic growth this century. The engineering challenges are immense and will require research and development investment in fields that have been relatively neglected until now: alternative energies, carbon sequestration, higher efficiency engineering, new lightweight materials for buildings and vehicles, and rebuilding old industrial and energy infrastructure with clean gear.

Yet despite the claims of the global-warming skeptics, the cost can be affordable. As the examples of companies in the *BusinessWeek*/Climate Group ranking show, there often is a boost to the bottom line. Far more substantial cuts are needed to make a real dent in the global-warming problem. And clearly, the developing nations need to be on board with cleaner technologies as well. But the news is that many companies are energetically tackling this growing environmental challenge. ■

–With Michael Arndt in Chicago, Amy Barrett in Philadelphia, and John Carey in Washington

A Hot Market for Carbon

Outside Bangkok, generators fueled by methane captured from manure make electricity. In China's Inner Mongolia, wind farms sprout up along the breezy steppes. In India's Andhra Pradesh state, villagers power their tractors with a cleaner-burning diesel substitute pressed from seeds of the mighty honge tree.

What do these far-flung projects have in common? They're all the result of the 1997 Kyoto Protocol, a global initiative to reduce emissions of greenhouse gases linked to global warming. The U.S. and a handful of other nations spurned the treaty, in part because it exempted emerging nations from making their own cuts. But the innovative financial systems that Kyoto inspired have made it relatively easy for developing countries to hop on board.

Under the Kyoto treaty, developed countries are required to cut emissions by an average of 6% from 1990 levels by 2012. Each country is permitted to emit a certain number of tons annually of carbon dioxide or its equivalent. Governments then issue emission "allowances" to polluters within their borders, and these can be bought and sold by companies worldwide. Through this carbon trading system, big polluters in developed countries can pay companies in developing nations to cut emissions in their stead. Since many factories in poorer nations use dirty, inefficient processes, you get more reductions for the buck by installing new, clean technology there than by replacing more modern equipment used in wealthy countries.

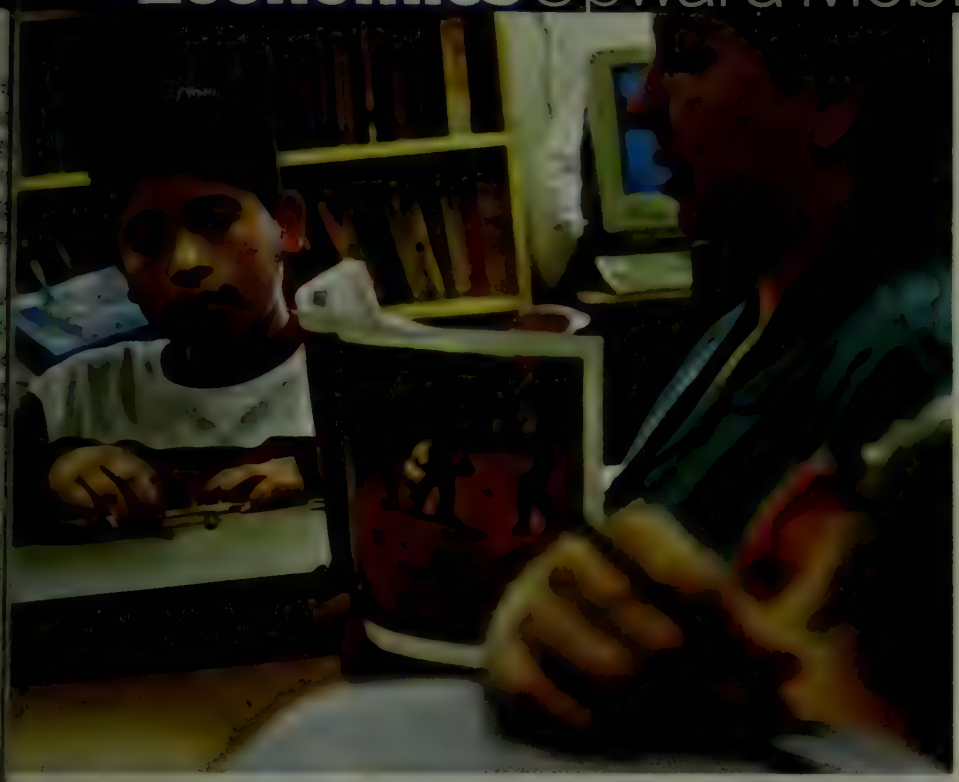
The system is helping foster green investments in nations that are home to some of the world's biggest polluters. Worldwide, developing countries are promising sweeping action, from cleaning up concrete plants, to sowing new forests that absorb carbon dioxide, to harnessing methane from decomposing garbage to generate power. So far, 39 projects have been registered with the U.N., and hundreds more are in the pipeline. Ultimately, the scheme could net as much as $12.5 billion for developing countries by 2012, the World Bank says. In August, a Japanese consortium joined up with a Chinese chemical maker to recover gases released in making refrigerants. The deal will result in a reduction of the equivalent of 40 million tons of CO_2—creating credits worth about $200 million. And Paris-based chemical maker Rhodia is cutting nitrous oxide emissions equaling as much as 13 million tons of CO_2 at its plants in South Korea and Brazil.

Since the Kyoto accord took effect on Feb. 16, the market for emission allowances has soared. Most of the action is on the Amsterdam-based European Climate Exchange, or ECX. Next year, volume on the exchange is expected to more than double to 700 million tons of CO_2 credits, and may reach 4.8 billion tons by 2008. "It's a large baby for its age," says Sara Stahl, an ECX economist. The baby is getting richer, too. Since the beginning of the year prices have more than doubled, to $26 per ton of carbon dioxide.

So far, credit purchases from developing countries are relatively rare, and more often than not they're funded by public institutions rather than private companies. But as more companies in the West get serious about meeting their Kyoto targets, purchases of credits from developing countries are expected to soar. "As the deadline gets near," says Andres Liebenthal, an environment specialist at the World Bank in Beijing, "there is going to be a scramble" for credits.

–By Frederik Balfour in Hong Kong, with Laura Cohn in London

REAP THE WIND
Generating clean power in Inner Mongolia



MAKING STRIDES ESL class in Forks, Wash.

The Melting Pot Is Still Melting

Unlike their counterparts in France, U.S. immigrants are getting ahead

BY MICHAEL MANDEL

THE EXPLOSION OF UNrest among the immigrant community in France revealed a long-stewing culture of economic discontent. Should we worry about the same thing happening in the U.S.?

The good news is that the American melting pot still seems to work. The latest data show big gains since the mid-1990s for immigrants on the key measures of economic performance—education, poverty, homeownership, and unemployment. In some cases, immigrants have shown bigger improvements than native-born Americans. "America has done extremely well in assimilating immigrants," says David Card, an economist at the University of California at Berkeley.

True, questions remain about the assimilation of illegal immigrants, many of whom are unskilled. Creating a class of "temporary workers" who have to go home after a few years—as President George W. Bush again advocated in a speech on Nov. 28—might exacerbate the problem by lessening the incentive for immigrants to learn English and become "more American."

Nevertheless, immigrants from Mexico and elsewhere in Latin America, who make up most of the illegal population, have enjoyed improving fortunes in recent years. Unemployment for Latin-American immigrants fell from 10% in 1996 to 6.8% in 2004, even as unemployment for natives rose from 5.9% to 6.1%.

This experience contrasts favorably with that of Europe, where immigrants have been held back, in part, by a slow rate of job creation. European employers, with few jobs to fill, have favored natives over first- and second-generation immigrants. This starts a vicious cycle, since the lack of work experience makes immigrants even less employable.

CAUSE FOR HOPE

IN THE U.S. THE EASE of finding work opens up opportunities, especially when the overall economy is doing well. Since the New Economy boom started in 1996, the poverty rate for immigrants has fallen from 22.2% to 17.2% (that's for 2003, the last figure available). The share of immigrants with a bachelor's degree or better has also climbed from 23.5% to 27.3%, just below the level for native-born Americans. The percentage of immigrants owning their homes—the ultimate sign of assimilation—has jumped as well.

These numbers do overstate the positive picture by mixing together Asian newcomers, who typically start off with a good education, with Latin-American immigrants, more than half of whom haven't graduated from high school.

But poverty has plunged even among Latin-American immigrants, while homeownership rates for that group have gone well over 40%. There are even signs of movement on the education front, albeit small. In California the number of Latinos graduating from the state's higher education institutions has been steadily rising. For example, the percentage of associate degrees going to students of Latino background rose from 18.7% in 1996 to 25.4% in 2003. And Latinos got 17.5% of bachelor's degrees awarded in California in 2004, up from 13.5% in 1996.

This isn't enough to close the education gap between natives and Latin-American immigrants. But it's enough to give immigrants and their children a healthy piece of the economic action—and that's a lot better than what's happening in Europe. ■

The Economic Progress of Immigrants

PERCENT OF IMMIGRANTS	1996	2004
WITH COLLEGE DEGREE	23.5%	27.3%
	1996	2003
BELOW POVERTY LEVEL	22.2%	17.2%

Data: Census Bureau

Coldwater Creek's Hot Run

Founder Dennis Pence has made the catalog retailer a force in the mall as well

BY STANLEY HOLMES

IN 1984, DENNIS PENCE LAUNCHED a catalog-only line of women's accessories and Native American-influenced gifts with $40,000, one telephone, and what he calls a "maniacal belief" in his entrepreneurial talents. He and his then-wife, Ann, had left high-paying marketing jobs in New York and moved to sleepy SandPoint, Idaho, where they ran the fledgling business, called Coldwater Creek, out of their apartment. Money was so tight that rather than pay United Parcel Service Inc.'s $6 pickup fee, Pence stuffed packages in a backpack, rode his bicycle two miles to town every day, and waited in line at the UPS office to process his 10 or so orders. "We were so cheap it squeaked," says Pence, now CEO of Coldwater Creek. "Dinner was tuna casserole without the tuna."

HOT GROWTH COMPANIES

It's fair to guess that tuna casserole—with or without tuna—is no longer on Pence's menu. Coldwater Creek, which caters to professional women and now offers a full range of what it calls casual and versatile clothing, is one of the nation's fastest growing retailers, with sales on track to increase 18% this year, to $698.4 million. Analysts estimate that profits will jump 52%, to $44.2 million.

Thanks to average annual profit growth of 137% over the three years that ended in May, Coldwater Creek landed at No. 70 on *BusinessWeek*'s annual Hot Growth ranking. Approving investors have jacked the company's stock up more than 60% in the last year, to about 31. Pence held a 20% stake in the company at the end of 2004 but has been unloading stock to diversify his personal investments; he now owns $335 million worth of shares in the company.

STRIP MALL POKER Pence plans to open some 500 stores over the next six years

Much of Coldwater Creek's growth has come from Pence's careful foray into bricks and mortar. The company has opened 170 stores since 1999, mostly in upscale strip malls. The shopping centers, located in upper-middle-class neighborhoods, cater to the company's core audience: women who earn an average of $70,000 a year and who are drawn to such Coldwater Creek staples as $79 burnished silk jackets and $65 reversib suede belts. The soft-spoken Pence h managed the retail chain's expansio without piling up any debt.

Coldwater's focus on affluent female "zoomers" is paying off

Pence is rushing to capitalize on emerging demographic group that reta experts have dubbed the zoomers. "Th are baby boomers with a zest for living says Lois Huff, senior vice-president Retail Forward Inc., a consulting firm Columbus, Ohio. "They've got lots money to spend, and they want to up grade their entire life."

PICKY SHOPPERS

THIS YEAR, THE YOUNGEST of the bab boomers turn 40 and the oldest turn 6 Zoomer women will make up the large percentage of femal shoppers over the ne decade. But becaus they often feel ignore by big departmen stores, they're apt to g hunting for alternativ shopping destination according to Pence "She's not happy wit the service she's receiv ing," he says. "She not happy with th quality of assortmen or the return privi leges." Pence woul like Coldwater Creek t be first among thos shopping alternatives.

Well, get in line Coldwater Creek is fa from the only retailer t recognize an opportuni ty in zoomers. Retailer such as Chico's (Ho Growth entrant No. 15 and Talbots are among some of Coldwater Creek's toughest competitors. Pence has been working hard to set his company apart Coldwater Creek was one of the first retailers to introduce stretch denim for older women who couldn't fit into the tight jeans sold by other stores. It offers clothes that can be worn to work and out at night. And the company lavishes shoppers with such attention that in a poll conducted by the National Retail Federation, Coldwater Creek was voted No. 1 in the nation for customer service in the specialty retailer segment. Every salesperson who takes orders by phone, for example, keeps a selection of clothes nearby so they can answer customers' most nitpicky questions.

Coldwater Creek was anything but an

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rnight success. At Sony Corp., where ce worked his way up to national sales ctor of consumer electronics, he built putation as an aggressive and ambi- s executive. Pence got his first sales there in 1976, after a Sony executive ked into the San Francisco electronics e where he was working and was ved by his persuasive selling tech- ue. But even with the help of his wife, o had written advertising copy for cy's, Coldwater Creek struggled to find ooting in the cutthroat retail business. t two years into their entrepreneurial ture, Pence had burned through their savings, and the stress was eating at . One day he thought he was suffering eart attack and was flown by helicopter hospital in Spokane, Wash.

t wasn't until the mid-1990s that Cold- ter Creek, which by then was offering re than just accessories, started to at- ct the attention of well-to-do, older men. But the strain of launching a siness, even one that eventually suc- ded, took its toll on the marriage. The ple divorced in 2003, and Ann no ger works for Coldwater Creek, though still has an estimated 20% stake in it. nce says there are no hard feelings. "We had an unusual combination of skill sets," he says. "I think without the one or the other neither of us would have made it."

These days Pence is focusing on his ambitious agenda to open about 500 stores over the next six years. He predicts that the expansion will push annual revenues into the $2 billion range. As he sits back in a conference room inside the company's sprawling 175,000-square-foot headquarters—now the largest building in SandPoint—Pence muses at how far Coldwater Creek has come. He recalls that the company's first employee, a typist, brought her own pillow to work every day to cushion the hard dining room chair that she sat on when she typed up packing slips. "We really didn't know what we were doing," recalls Pence, "but we had great confidence in ourselves." ■

BIO

Dennis Pence

Pence gave up a high-level sales post with Sony in New York to start the specialty retailer

BORN Dec. 30, 1949, in Piqua, Ohio

EDUCATION B.A. in philosophy and religion, Antioch College, 1972

POSITION: CEO of Coldwater Creek, a retailer that he co-founded in 1984 in his apartment in SandPoint, Idaho

ODDEST MOMENT: Stepping outside after a full day working in his apartment and coming face to face with a moose

PREVIOUS JOB: National sales director for Sony Corp.

FAVORITE BOOK: *Total Quality Control for Management: Strategies and Techniques from Toyota and Toyoda Gosei* by Masao Nemoto

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RUSSIA Conoco is raising its stake in Lukoil to 20%

The Making Of an Oil Major

Jim Mulva's boldness put ConocoPhillips in the top tier. And his big bets haven't stopped

BY MARK MORRISON

IF YOU ASKED CENTRAL CASTING for an oil company CEO, you would not get James J. Mulva. He's a mild-mannered, soft-spoken number cruncher who started his career in the Phillips Petroleum Co. treasury office. In an industry filled with hard-nosed petroleum engineers, Mulva comes across as way too low-key to be the boss of ConocoPhillips, the No. 3 American major, behind Exxon Mobil and Chevron.

But his actions paint a portrait that's more Mr. T than Mr. Rogers. As chief executive officer of the sleepy Bartlesville (Okla.)-based Phillips, Mulva conceived the bold $16 billion deal that created ConocoPhillips in 2002 and vaulted it into the league of energy giants so large they're called supermajors. Now he's shaping up as an aggressive risk-taker willing to place multibillion-dollar bets in the most volatile places on earth. All of the industry's big players are swimming in cash, but Mulva is plowing some 70% of the company's expected cash flow back into the business, compared with 60% at Chevron Corp. and 35% at Exxon Mobil Corp. (table). "We're aggressive about where want to be five years from now," Mu said to analysts on Nov. 16.

EMBRACING RISK

MULVA'S ASCENT into the superma stratosphere was underscored by his a pearance—along with execs from Exx Mobil, Chevron, BP, and Shell—before t Senate to defend "windfall profits" a "price-gouging" on Nov. 9. But Cono Phillips, foremost among the majors, is having much as Big Oil's critics would ha it behave. That's in stark contrast ExxonMobil, for one, which has pleased t Street by paying down its debt practically zero and unapologetically refusing to dr matically ramp up its reinvestment rate.

The risk-embracing strategy has earn Houston-based ConocoPhillips a low price-earnings ratio than its rivals. St Mulva vows to boost production 3% ann ally. To that end, he's jacking up the co pany's share of Russian energy produc Lukoil to 20% (from 15% now), pushi ahead on drilling projects from Alaska a Australia to Venezuela and Vietna preparing to splurge on liquefied natur gas projects, and even spending big to e pand investment-starved U.S. refinerie Next year, Mulva will hike ConocoPhilli capital budget to $11.1 billion, up 16% fro 2004. His spree will look brilliant if su plies stay tight—but misguided if pric drop to 1990s levels. Mulva declined comment for this article. (Harold McGra III, chairman and chief executive of T McGraw-Hill Companies, *BusinessWee* parent, is a ConocoPhillips director.)

A banker's son, Mulva was born f from the oil patch, in Green Bay, Wis., 1946. He and his brother, Patrick T. Mu va—who happens to be corporate vic president and controller of ExxonMobil- both earned MBAs at the University Texas at Austin. Jim Mulva became fasc nated with the oil business while st tioned in Bahrain as a U.S. Navy office

Smallest Supermajor

ConocoPhillips is plowing its huge profits into aggressive exploration projects faster than rivals, but the market is penalizing it as a result.

COMPANY	MARKET CAP (BILLIONS)	REINVESTMENT* RATE	P-E RATIO
ExxonMobil	$365	35%	11.1
BP	245	50	12.3
Chevron	128	60	9.1
ConocoPhillips	86	70	7.1

*Capex as a percentage of 2005 cash flow. **Data:** Capital IQ, A.G. Edwards

CEO MULVA If prices stay high, his strategy will really pay off

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Marina Del Bue
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but his first brush with it came earlier: His high school job was fueling planes at a Green Bay area airport.

He has a much more privileged view of the energy industry now. But at ConocoPhillips, Mulva faces a daunting business challenge, with expenses and political risks rising. The cost of finding and developing a barrel of oil has more than doubled in the past few years. At the same time, the company is also hoping to return to troubled countries such as Libya and Iraq as soon as possible. And its investment in Lukoil, which will hit $9.5 billion by the end of next year, exposes ConocoPhillips to the risks of abrupt change in leadership post-Vladimir V. Putin. Further, Russian state taxes and fees run close to 90% on oil revenue above $25 per barrel.

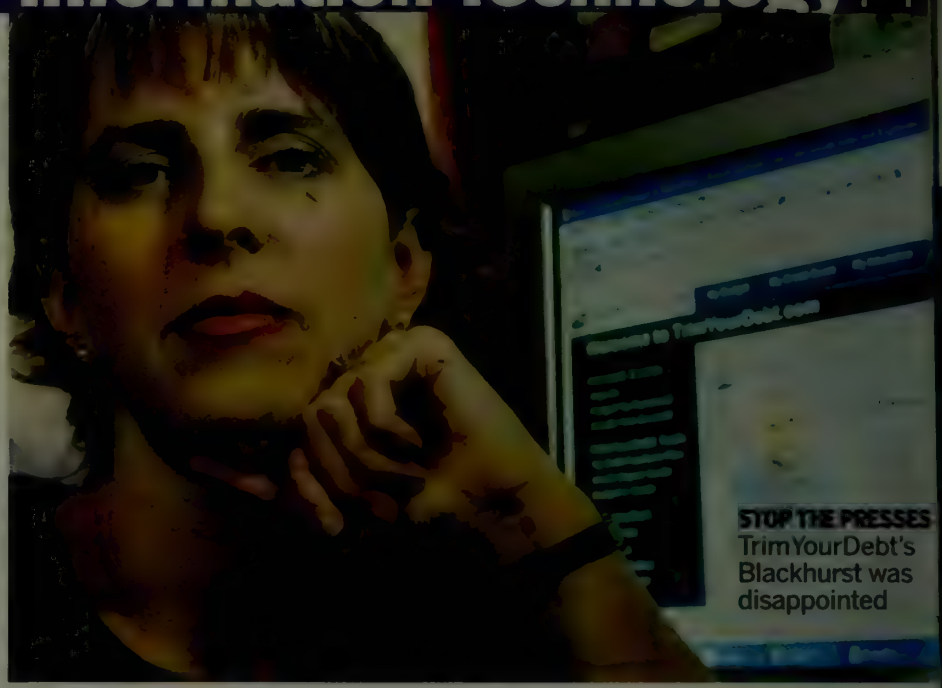
DEFT MOVES?

OF COURSE, ACCEPTING huge risks means the chance of enormously lucrative rewards. On top of its equity ownership, ConocoPhillips is a joint-venture partner with Lukoil, drilling two potentially major new fields in Northern Russia. The alliance with Lukoil, a sizable player in Iraq before the war, may also help the partners win a major piece of Iraq's energy business—if and when security and politics are stabilized. "Together they could get 35% of one of the largest undeveloped fields in the world," says Oppenheimer & Co. energy analyst Fadel Gheit. "If they do—and it's admittedly not likely anytime soon—the payday for Lukoil and ConocoPhillips will be beyond anybody's imagination."

Mulva hasn't been right all the time. He'll spend $4 billion over the next five years to add capacity to ConocoPhillips' refining operation—already the second-biggest in the U.S. But analyst Gheit notes that with refinery margins benefiting from tight capacity and robust demand, it will probably cost five or six times as much to add capacity as it would have five or 10 years ago, back when No. 1 refiner Valero Energy Corp. moved aggressively to expand.

Even with the benefit of hindsight, Mulva has done a lot right. His aptly timed Conoco acquisition put the company in a position to benefit from a new global dynamic of rising energy demand that could last into the next decade. And his bold plans may ultimately prove that he adjusted more wisely and quickly to the changing world of energy than the other majors. Right or wrong, no one will accuse Mulva of being shy. ■

–With Jason Bush in Moscow



STOP THE PRESSES TrimYourDebt's Blackhurst was disappointed

Can Google Go Glossy?

Why its plan to resell print ads to its army of advertisers may be off to a slow start

BY BEN ELGIN

IT WAS A BABYSTEP THAT SENT tremors through the media establishment. Seeking ways to expand its advertising juggernaut beyond the Internet, Google Inc. this fall purchased about a dozen pages of ad space from niche publications such as *PC Magazine* and *Budget Living*. Google then divvied up the space and sold it in small pieces, often four to seven per page, to its network of several hundred thousand advertisers—most of whom can't afford pricey magazine ads on their own. Now Google says the trial program, dubbed Google Publication Ads, is taking off, with hundreds of publications inquiring about it. The company is expanding the trial from four publications to scores of them, likely to include both niche and general interest titles.

However, a closer look at Google's foray into magazine ads suggests it could be in for a tough slog. Sure, plenty of publishers are clamoring to snare ad dollars from Google. But a *BusinessWeek* analysi of Google's pilot, including interview with 10 advertisers and two publishers indicates that advertisers haven't warmed to the program so far. Only one of 10 advertisers interviewed by *BusinessWee* said their print ad performed wel enough to recoup the money it cost. And eight of the 10 were unhappy enough with the results that they say they're unlikely to do further print advertising with Google. "The response was definitely less than we expected," says Ken Chang, director o operations at Apex Security Solutions, a seller of networked security cameras which purchased an ad through Google in *PC Magazine*'s Oct. 18 issue.

The lackluster results came despite deep discounts in magazine ad rates. Some ad pages were sold by Google for as little as one-quarter of the listed ad rates at these magazines, according to information provided by participating advertisers. It raises the question: If most marketers are reluctant to re-up, despite Google and the magazines forgoing

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profits, can this endeavor become a moneymaker for all the parties involved?

Certainly, Google has proven itself a versatile, innovative company and it could modify its approach in magazines to boost its chances at success. Still, the early feedback should be worrisome for Google. Its Internet ad business is going gangbusters, with 2005 profits expected to climb fourfold, to $1.6 billion. But with its stock at a stratospheric $400 per share, giving it a market valuation of $120 billion, many investors are betting Google can expand beyond the online text ads that constitute 98% of its sales—into splashy online image ads, as well as new mediums such as radio, TV, and print.

GOOD ON PAPER

ON THE SURFACE, print ads make a lot of sense for Google. Magazine ads are expected to generate about $22 billion in the U.S. this year, compared with the $13 billion anticipated for online ads, according to researcher eMarketer Inc. Plus, Google boasts relationships with hundreds of thousands of small advertisers. By selling bite-size chunks of these ad pages, it hopes to draw in thousands of marketers who otherwise couldn't afford magazine ads. Google's ultimate goal: to extend its position as the nexus between advertisers, publishers, and customers beyond the Internet. Says Timothy Armstrong, Google's vice-president of advertising sales: "Advertisers are always looking for more places to show profitable ads."

But Google faces a couple of daunting hurdles in print ads. Foremost, most magazine ads aren't geared toward direct marketers, which constitute the bulk of Google's advertisers. Take TrimYourDebt.com, an online business that sells tools to individuals to reduce credit-card and other debt. TrimYourDebt's goal is to send users to its Web site, something it has done profitably by purchasing text ads next to Google searches for terms such as "debt consolidation."

But when TrimYourDebt tried Google's print ads, it found the approach far less profitable. Indeed, Google's core strength—algorithms that link the appropriate ads with each search query or page of online content—is much more difficult to apply offline. After buying a small portion of an ad page in *Budget Living*'s November issue for approximately $3,000, responses trickled in a couple of weeks later. TrimYourDebt declared the trial a disappointment, estimating it would generate less than one-tenth as many leads as a similarly priced online campaign. "The whole power of the Web is to bring targeted visitors to your site," says Jennifer Blackhurst, co-founder of TrimYourDebt. "The print ad hasn't done this, so it didn't justify the cost."

Google's other major problem: It can't simply lower the asking price on print ads, as it can online, to the point where they make sense for marketers. On the Web, Google lets advertisers bid against each other for placement alongside search results. Since it costs Google essentially nothing to give each surfer results to their query, it can afford to let advertisers bid a few pennies for every time their ad gets a click. But producing and distributing magazines can be expensive, so publishers can't sell ads for pennies.

There's another hitch. Magazine publishers display ad prices on rate cards and typically give large marketers discounts from those rates. Publishers are reluctant to provide Google with bigger discounts than its best advertisers for fear of seeing rates collapse. "We'd need to make sure we're maintaining the same rate we charge other large advertisers," says Susan McNamee, group publisher at Active Interest Media Inc., which publishes titles such as *Better Nutrition* and hasn't participated in Google's program.

Google is already getting some of the cheapest possible ad rates, according to two participating publishers. For instance, Google has purchased several one-page ads from *PC Magazine* for approximately $20,000 apiece, according to a source familiar with the transactions. That's about one-quarter of the price listed on the magazine's rate card—and below the level where *PC Magazine* makes a profit, says the source.

Even with such discounts, Google appears to be reselling ad spots without making money itself. For *PC Magazine*'s Oct. 18 issue, Google resold a one-page ad to seven advertisers. *BusinessWeek* reached four of those, who paid an average of $2,750. Assuming that average for all seven advertisers, Google generated $19,250 for the ad, leaving scant room for profits since its cost was about $20,000.

Still, Google isn't backing away from the market. Co-founder Sergey Brin lauded the ad program during Google's third-quarter conference call in October. And ad-sales chief Armstrong says Google is working hard to improve its performance. "We view this as a long-term R&D project," says Armstrong, who wouldn't comment on specifics about pricing. "We're not as concerned with profitability right now as we are with finding value for publishers, advertisers, and customers."

Google certainly has the cash and patience to sustain a lengthy effort to penetrate the magazine advertising arena. But based on this assessment of Google's initial foray, don't expect it to replicate its online successes anytime soon. ■

Extra! Google Tries Selling Magazine Ads

Advertising in popular magazines has long meant an investment of over $10,000—too steep for many small businesses. Google is hoping to change that with its pilot magazine program. Here's how it works:

STEP 1

Google purchases ad pages in publications such as *Budget Living*. Then the search giant approaches companies that use its online advertising and may be a good fit for the magazine's subject matter.

STEP 2

Interested advertisers pay Google a set fee, often between $2,000 and $3,000. Ad sizes have ranged from 1/7 of a page to the entire page.

STEP 3

Google tries to measure the customer response to magazine ads with the same sort of performance data that advertisers get online. It does so with customized toll-free numbers and Web pages.

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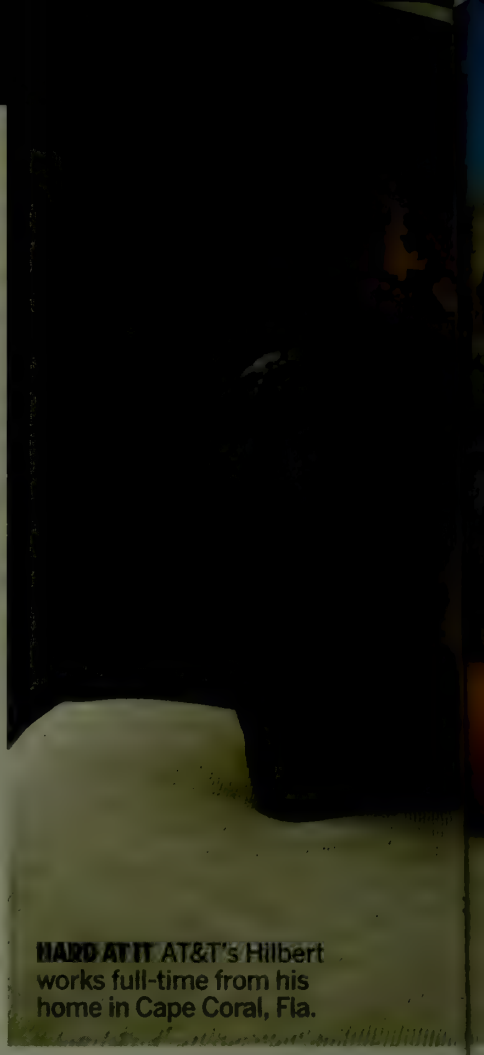
The Easiest Commute of All

The ranks of remote workers are swelling as companies see the sense in freeing them

BY MICHELLE CONLIN

ON THE EDGE OF ALBUquerque lies a mammoth expanse of hills and horizon called Mesa del Sol. This celluloid-worthy, clay-colored plateau sprawls for over 25 square miles. It's the last parcel of its size in North America that is so close to both a central business district and an international airport. When ground broke in October, the unspoiled scrub began giving way to what will eventually become one of the largest planned—and technologically tricked out—communities in the nation, a place that will offer 310 sunny days a year in a climate balmier than Colorado's, cooler than Arizona's, and cheaper than either. A place where you can hit the slopes in the morning, tee off after lunch, and then jam in some collaboration with co-workers in India before David Letterman. In other words, a desert idyll for those who want to go off the grid but remain connected, and keep their New Economy-size paychecks while living a New Mexico-priced lifestyle.

Or so the pitch for this broadband nirvana will go. Mesa del Sol, designed by New Urbanism guru Peter Calthorpe, will be the first place of its kind built from scratch and targeted at the creative class. A big marketing push will be made to coastal knowledge workers looking to cash out of their million-dollar split levels, move inland, and work remotely for their companies. Mansionettes will carry price tags of up to $400,000, about the same as the average Manhattan studio. They'll feature home offices sequestered from family foot traffic and fully wired for transnational connections. Business centers strewn throughout the community—all within a short walk or electric-cart ride—will offer rent-by-the-hour support staff plus state-of-the-art meeting rooms and seamless videoconference hookups to China and India. With the Albuquerque airport only six minutes and one stoplight away, a former regular of the big-city airport crush can leave for meetings in other cities after breakfas and still be home for dinner.



HARD AT IT AT&T's Hilbert works full-time from his home in Cape Coral, Fla.

Mesa del Sol's developer is Forest Cit Enterprises Inc., the same company be hind the "sustainable" Stapleton devel opment outside of Denver—where hous es are so hot there's a lottery to get o the waiting list—and the MetroTech Center in Brooklyn. The company's professorial co-chairman, Albert B. Ratner has personally handed out hundreds o copies of Richard Florida's book, *The Rise of the Creative Class*, to pretty much anyone who will take one. Like Florida Ratner believes that the future of work belongs to those who will log their hours when they want, how they want, and most important, where they want. Companies will hire brains, not bodies. Thus Ratner's bid to lure Mensa types to the Mesa.

The builder is clearly on to something. More and more, the creative class is becoming post-geographic. Location-independent. Office-agnostic. Demographers and futurists call this trend the rise of "the distributed workforce." Distributed workers are those who have no permanent office at their companies, preferring to work in home of-

PLAYBOOK: BEST-PRACTICE IDEAS

If You Want Them, Let Them Go

Increasingly, highly sought-after knowledge workers want to work where they choose on their own schedules. Here's how companies are managing these post-geographic workers successfully:

- Pay the bill for a high-speed-access home office
- Make managers work remotely to set an example for their employees
- Evaluate workers on output, not face time
- Schedule regular, mandatory times for teams to gather physically
- Offer employees a choice: Some function best in an office environment

Data: *BusinessWeek*

One customer service engineer at Agilent hasn't even laid eyes on his boss in nearly three years

ces, cafes, airport lounges, high school tadium bleachers, client conference ooms, or some combination of what lorida calls the "no-collar workplace." hey are people who do team projects ver the Web and report to bosses who hay be thousands of miles away. Curently, about 12% of the U.S. workforce ualifies as distributed, estimates harles Grantham and James Ware, excutive producers of Work Design Colaborative LLC in Prescott, Ariz. But in rban areas, they figure the number is loser to 15%. "Anytime 15% of any poplation is doing new behavior, you know t's going to take off," says Grantham, vho predicts that 40% of the workforce vill be distributed by 2012. "We're at a ipping point."

Many technology companies are aleady there. At IBM, 40% of the workorce has no office at the company; at T&T, a third of managers are now postgeographic. The growth of globalization, ndependent contractors, extreme commutes, expensive gas, and the broadband-connected micropolis are all continuing to build the ranks of the location-neutral, especially at troubled tech outfits for whom the cost savings can be a godsend.

FAR-FLUNG EFFICIENCY

AT SUN MICROSYSTEMS INC., nearly 50% of employees can work from home, cafes, drop-in centers, a company office, or some combination thereof—saving the company $300 million in real estate costs, says Bill MacGowan, Sun's senior vice-president for human resources. Agilent Technologies customer service engineer Walt Swanson hasn't seen his boss in nearly three years. More and more at Agilent, that's becoming the norm. In 2003 the company closed 48 U.S. sales offices and swiftly instructed all the employees to work from home (chart, page 80). Today, 70% of Agilent's workforce is connected remotely either some or all of the time. The company estimates that these virtual workers cost 60% less. "I get to sit here and look out my window while I talk to customers—and watch the leaves changing, squirrels running around, and kids going off to school," says Swanson, who works in a spare bedroom in his Knoxville (Tenn.) home.

Indeed, at many companies across America, the most innovative new product may be the structure of the workplace itself. Today, every knowledge worker has the tools to work from pretty much anywhere: a laptop, a mobile phone, and global, high-speed Internet access that is becoming as ubiquitous as pay phones used to be. Teams are increasingly transnational, warming undersea cables with Net meetings, conference calls, and collaborative projects involving large, far-flung groups. Increasingly, no one is sure of where anyone else is anymore; what's amazing is how little it appears to matter.

The office is stretching right along with the workday. With demands increasing to show up for meetings before the sun comes up and after it goes down, the ability to work from anywhere is becoming a necessity. "If staff meetings are at 5 a.m. or 10 p.m., I can guarantee you I'll be attending them at home in my jammies and robe," says Laura Dionne, Intel Corp.'s director of supply-chain transformation. The trade-off for Dionne is that she has also been able to reclaim the dinner hour with her husband and three kids. "That's prime time, and I protect it," says Dionne, who manages a remote team

of 200. She credits Intel's aggressive virtual-work program with enabling her to hang on to key talent she might otherwise have lost, especially working moms. "Technology allows working remotely to be completely invisible," says Dionne.

It's ironic that even as employees are farther away, companies are capable of keeping even closer tabs on them. Executives at Agilent can monitor engineer Swanson's output anytime they want. Swanson says daily reports keep a rundown on what he does: when he answered a call, how long it took him to resolve a technical issue, and how much time passed before he put the phone back into "ready" status. "They know more than in the old days when I had an office next to my boss," says Swanson, a high performer who the company treated to a trip to Cancún this year.

For those on the lower end of the knowledge worker spectrum, whose output can be easily monitored, it can mean more Big Brother oversight. For those on the high end, it can mean more hours but more flexibility. In a sense, time and flexibility are becoming a new kind of career currency in on-demand careers that never stop. "I'm on call 24 hours a day, seven days a week, 365 days a year," says AT&T's manager of worldwide safety programs, Allen Hilbert. Hilbert works out of his Cape Coral (Fla.) home—often with his legs up on a chaise lounge in his lush backyard. Fully 85% of the safety staff works virtually. "If I get a call at 1, 2, or 3 a.m., I can get across the house to my office and service the customer right there."

HIGH-SPEED HAPPY PEOPLE

WHY SHOULD managers like Hilbert commute two hours a day, as he used to do, only to park themselves at a computer to send e-mails or yak on the phone to clients and employees in different time zones, countries, and continents?

Of course, nothing can supplant the intellectual electricity of knowledge workers brainstorming in person. But companies are finding that allowing workers the flexibility to work remotely contributes to increased productivity. Sun says its virtual workers are 15% more productive than their office-tethered brethren. "Our people working these remote schedules are the happiest employees we have, and they have the lowest attrition rates," says Sun's MacGowan. The need to seduce and keep star talent also plays a role. "Would I rather settle on someone mediocre in the Bay Area, or get the best person in the country who is willing to work remotely?"

Sun employees don't even need to lug their laptops around anymore. Workers can stick a Java Card into any Sun machine—from Texas to Tokyo—and their desktops and data will appear. "We don't even need PCs or laptops anymore," says Sun's senior director of the iWork Solutions Group, Ann Bamesberger.

Not only is flexibility an employee accommodation, it is also increasingly seen as a crucial management strategy that can improve worker performance and company financials, according to a recent study released by Corporat Voices for Working Families. It's key to retaining younger workers a well. At Boeing, the average em ployee is 46 years old, says Jeffre Hobbs, Boeing Co.'s director of th workplace of the future. So to dra younger workers, the company ha no choice but to offer the flexibilit they prize. Yet its virtual work pro gram is a smash with all ages. "C the 8,000 employees participating I've only heard of a few who hav said they want to come back to a regula office," Hobbs says.

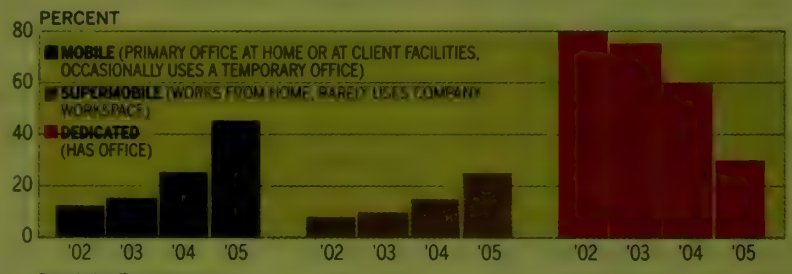
Still, many gray-flannel managers ar leery. How do you supervise someone sit ting miles instead of inches away? "Peo ple used to managing visually are a littl bit reluctant at first," says Hobbs. Accli mating managers to judge people on out put, not face time, takes time, training and sometimes the example of senior ex ecutives working virtually, in part t prove to underlings that doing so won' set them back. In the end, says AT&T's di rector of telework, Joseph Roitz, peopl are "not going to make it in the globa knowledge economy unless they car work with and influence people beyon their line of sight."

Not that offices will ever become obso lete. But companies used to figure the tal ent would come to them. More and more they are going to have to figure out how t get the work to the talent. ■

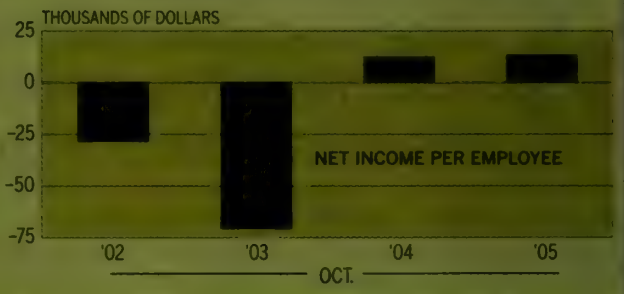
AGILENT TO EMPLOYEES: STAY HOME

In October, 2003, a struggling Agilent Technologies closed 48 U.S. sales offices and rolled out a massive program allowing white-collar employees to work remotely. Now the testing-equipment maker is a zealous advocate of the virtual workforce concept

As Agilent's workforce has become more virtual...



...financial performance has improved



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SEMINOLE GAMES Trump wants in on the action

Trump's Angry Apprentice

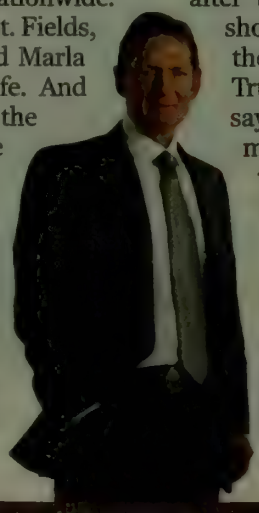
Richard Fields is battling his former mentor over a $1 billion stake in Indian casinos

BY EAMON JAVERS

RICHARD T. FIELDS could have been a real-life forerunner to Donald Trump's reality show, *The Apprentice*. From 1995 to 1999, he learned the casino business at The Donald's side as a consultant, and the pair had visions of expanding Trump's New Jersey-based gaming operation nationwide. And why not? They were tight. Fields, a show biz promoter, advised Marla Maples, Trump's second wife. And Fields' wife, Meeka, was in the room with Maples when she delivered daughter Tiffany.

But this partnership has turned rockier than anything depicted in Trump's TV boardroom. A cozy relationship has given way to a blood feud, rife with allegations of dishonesty. Locked in an ongoing legal battle over a Florida casino project, Trump and Fields have filed dueling briefs that reveal the depth of their animosity. At stake: more than $1 billion.

Trump charges that Fields betrayed him by snatching away a plan to build two casinos on land owned by the Seminole Indian Tribe of Florida. He says his protégé misled tribal negotiators into thinking Fields still consulted for Trump after the two had parted. "This guy should be the most thankful guy in the world that he met Donald Trump," the 59-year-old developer says in an interview. "Before he met me he had virtually nothing. I taught him the business, and then he went out and took advantage of the situation unfairly."



FIELDS He alleges Trump engaged in self-dealing

Hardly, replies Fields. Now 60, he was no wet-behind-the-ears B-school grad: Fields was once part-owner of the Catch a Rising Star comedy club and helped promote rocker Pat Benatar. Now he charges that Trump is trying to get his hands on a profitable deal that he passed up years ago. "Donald Trump has built a career bullying and litigating in the courtroom—trying to accomplish what I could not do in the boardroom," Fields tells *BusinessWeek*. "Trump's P.T. Barnum act may work with some folks, but in this case he's facing unintended consequences for his continued bad behavior."

The saga unfolds in a series of legal filings. In December, 2004, Trump sued Fields in Broward County Circuit Court. Fields fought back in Florida and by intervening in the bankruptcy of Trump's public company. That outfit, Trump Hotels & Casino Resorts Inc., filed for bankruptcy protection in November, 2004, and emerged last May as Trump Entertainment Resorts Inc.

EXPENSES QUESTIONED

TRUMP SAYS Fields first came to his attention in the early '90s. "By 1995 Fields's position grew to being a confidant and one of a select group of individuals who enjoyed access to Donald Trump at virtually any time," Trump's suit says.

In 1997, Maples and Trump split, and by 1998 Trump and Fields were at loggerheads. Trump ordered an investigation into Fields's expenses. Fields says Trump's accountants cleared him. Trump maintains that Fields couldn't account for the funds—but he nonetheless kept him on contract as a consultant, under tighter controls.

In that role, Fields negotiated on Trump's behalf with the Seminoles to build and manage casinos on tribal property. Fields maintains in court documents that Trump was only interested in building "Class III" casinos, offering pure games of chance, such as slot machines, craps, and roulette. When Florida Governor Jeb Bush nixed the idea, "Trump directed that the effort be terminated entirely," Fields's filings say.

But Fields says Trump gave him the green light to try on his own. That's backed up by an affidavit signed in August from Mallory E. Horne, a lobbyist hired by Trump. Horne testified that he told Trump and Fields in late 1998 that Florida officials wouldn't budge. According to Horne, Trump replied, "That's the end of it," then told Fields: "If you want to try this on your own, Richard, that's fine, but I'm through with it."

Trump tells *BusinessWeek* the affidavit

is "total nonsense," and insists that when the suit goes to court, he'll produce witnesses to back his account of betrayal. The tycoon charges that Fields gave the Seminoles the impression that he was still working with Trump. The tribe's leadership has changed since a contract was signed in 2000 to build two Class II casinos, which offer variations on bingo and card games like poker. They didn't require rida's blessing. Seminole kesman Gary Bitner declines to nment on the lawsuit. The former bal chief could not be reached for nment after repeated tries through tribe and independently.

UMP Says lds used name

Fields insists that he never misled yone. He brought in Cordish Co., a ltimore-based real estate developer. gether they built the Seminole Tribe Florida Hard Rock Hotel & Casinos in mpa and Hollywood, Fla. Class II sinos are not normally as lucrative as ass III facilities. But the Seminole sinos, opened in March and May, 04, have been wildly successful: They ke in revenues of $1 billion annually. rlier this year, the Seminoles decided buy out Fields and Cordish for a rerted $1.2 billion. Talks are ongoing.

After the casinos took off, Trump ed Cordish and Fields. Cordish says a statement that Trump's suit is rivolous." Fields's response has been ore pointed: He has filed his own und of charges. Fields alleges in urt documents that Trump engaged a "host of questionable insider transtions," using company funds to suport a lavish lifestyle.

Trump and his employees say there's othing to Fields's accusations. "We ay [Trump] a salary and we reimburse im for his documented expenses, and at's it," says Scott C. Butera, chief rategic officer for Trump Entertainent Resorts.

Who's right in this war of words? arring a settlement, it will be up to lorida courts to decide. In the eantime, the Trump-Fields reality now seems headed into another seaon just as edgy as anything on the mall screen. ■

–With Amy Borrus in Washington and David Polek in New York

Making the Fine Fit the Crime

Chris Cox, on a crusade for clarity, will issue new guidelines for the SEC

BY AMY BORRUS

WHILE ITS BACKlog of big enforcement cases grows, the Securities & Exchange Commission is getting ready to publish guidelines on a question that has split the agency's commissioners for a year: When should the securities cops impose stiff fines on corporate wrongdoers?

SEC insiders say settlements in major fraud cases are stacking up while new Chairman Christopher Cox pushes for standards. Hammering that out hasn't been easy. The five commissioners have met behind closed doors four times this fall for two hours at a stretch. In a Nov. 29 interview with *BusinessWeek*, Cox said he hopes to publish the guidance by yearend.

The new standards won't lay down the size of fines. But investor advocates see a strong chance that business will emerge with a smaller risk of mega-fines.

Mega Levies

Three of the biggest penalties* for accounting fraud are:

WORLDCOM	$750 million
ADELPHIA	$715 million
TIME WARNER	$300 million

* Civil fines, disgorgement of ill-gotten gains, and interest

Data: Securities & Exchange Commission

UNAMBIGUOUS

THE PUSH IS a deft move by Cox. His fellow Republicans, Paul S. Atkins and Cynthia A. Glassman, rebelled in the SEC's private sessions against some stiff fines handed down under former Chairman William H. Donaldson. Spelling out rules could end the infighting and give corporate leaders an unambiguous signal. "There needs to be a very clear understanding of what the law requires of us and, among Americans, what the law requires of them," says Cox.

Until recently, the SEC was reluctant to hit companies with big fines. Officials reasoned that penalties hurt shareholders whose stocks had already been hammered by scandal. But the 2002 Sarbanes-Oxley Act let the SEC use the funds to repay stockholders, and the agency jacked up fines. Accounting frauds cost WorldCom, now MCI Inc., $750 million and Qwest Communications International $250 million. But since Cox was sworn in on Aug. 3, the SEC has not imposed penalties topping $10 million against any company—leaving corporate lawyers puzzled about the chief's enforcement priorities.

Cox says he wants "a series of objective measures so there can be continuity from case to case." That's easier said than done, warns Georgetown University law professor Donald C. Langevoort. A good baseline, he says, is whether a company benefited from its wrongdoing. Commissioners will also debate how much credit a company should get for dumping its CEO or cooperating with the SEC, he says.

Companies will want a high threshold for fines. But corporate lawyers just want guidance. "There needs to be an understanding that certain behaviors will get certain punishments," says Diane E. Ambler of Kirkpatrick & Lockhart Nicholson Graham LLP. Any signposts will be better than today's unmarked landscape. ■

A Stronger Dollar? Don't Bet on It

Wells Capital Management's investment ace sees the greenback heading south again

THE MUCH-MALIGNED DOLLAR recently hit a two-year high against the euro and the yen. Can the rally last? Jim Paulsen of Wells Capital Management in Minneapolis thinks not. Associate Editor Toddi Gutner spoke with Paulsen, chief investment strategist at the firm, which manages $165 billion, about his contrarian view of the greenback.

Can you put this rally into perspective?

One of the most important things to realize is that the dollar has been free-floating for only about 35 years. Prior to that it was pegged to gold. With the little history we have, we know that the cycles of strengthening and weakening are fairly long—7 to 10 years. Right now we're in only year three of a weakening cycle.

How do you explain the recent strength?

The dollar is up only a modest amount. Measured by the currencies of the countries we trade with, it's up 13% this year, but it's still down 25% from the '02 peak. Look at the stock market, which rose for 20 years. There were times when prices fell. It's the same with currencies—the longer-term trend suggests weakness. We're in a countertrend.

What is causing this countertrend?

First, look at how far the dollar had fallen already. By the end of last year it was down 40% against the euro and 25% against the yen. It fell too much, too fast—and the countertrend corrects that. Another factor is oil, which is priced in dollars. Every petroleum-importing nation needs to purchase dollars to purchase oil. So higher oil prices mean more dollars are floating around abroad. At some point foreigners may not want to hold so many dollars, and that could lead to a sell-off.

> "[Historically] cycles of strengthening and weakening are...7 to 10 years. Right now we're in only year three of a weakening cycle"
>
> —*Jim Paulsen*
> *Wells Capital Management*

So the rally is not sustainable?

Correct. The dollar will weaken next year against the developed nations' currencies and then the rest of the developing nations in 2007 and 2008. Developing countries, such as China and Mexico, must be forced to revalue. [China has made one small revaluation, but has resisted further changes.]

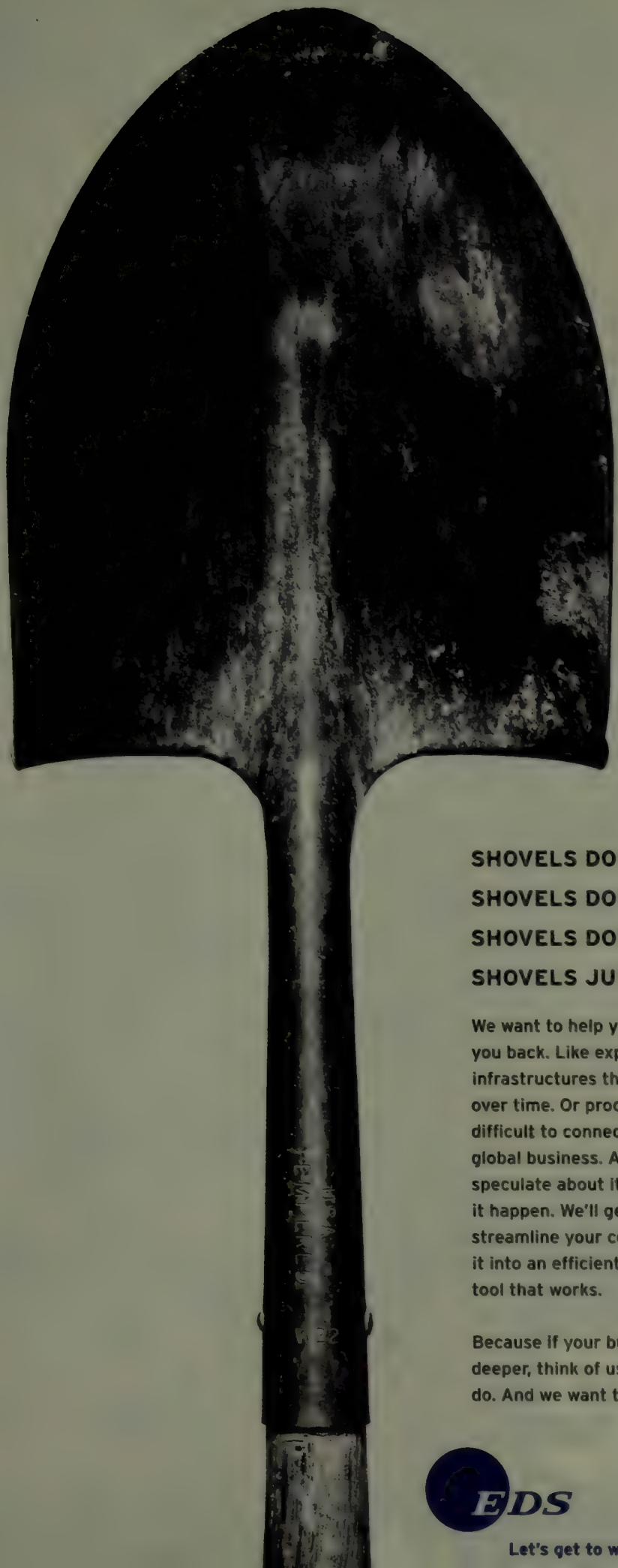
I think we can make China revalue, and we have already started. This is less an economic deal than a political deal. The U.S. and the rest of the G-7 will start to put up trade barriers. Once we get a more meaningful revaluation with China, I believe the rest of the Pacific Rim countries will follow.

More of our trade deficit is caused by gross undervaluations in foreign currencies than our lack of competitiveness. If those currencies were allowed to float, they would undoubtedly rise. Sure, the dollar would weaken, but that would give our exporters a big boost.

What about the impact of interest rates on the dollar?

While U.S. rates are a good deal higher than in Europe and Japan, capital does not always flow to the currency that offers the highest rates. We've been higher than the yen forever, and there have been times when the yen has strengthened against the dollar. It's not just the differential in interest rates, but how much that differential is changing.

The real question, though, is whose rates will rise more? If U.S. growth continues at the same rate as this year, and Japan's and Europe's growth accelerates, it's a good bet their interest rates will go up more. The yield differential might start to close even if our rates are higher. Japan is considering tightening moves, and that would strengthen the yen. It also looks as if euro rates might start to go up too, which also means the dollar will be slightly less attractive. ■



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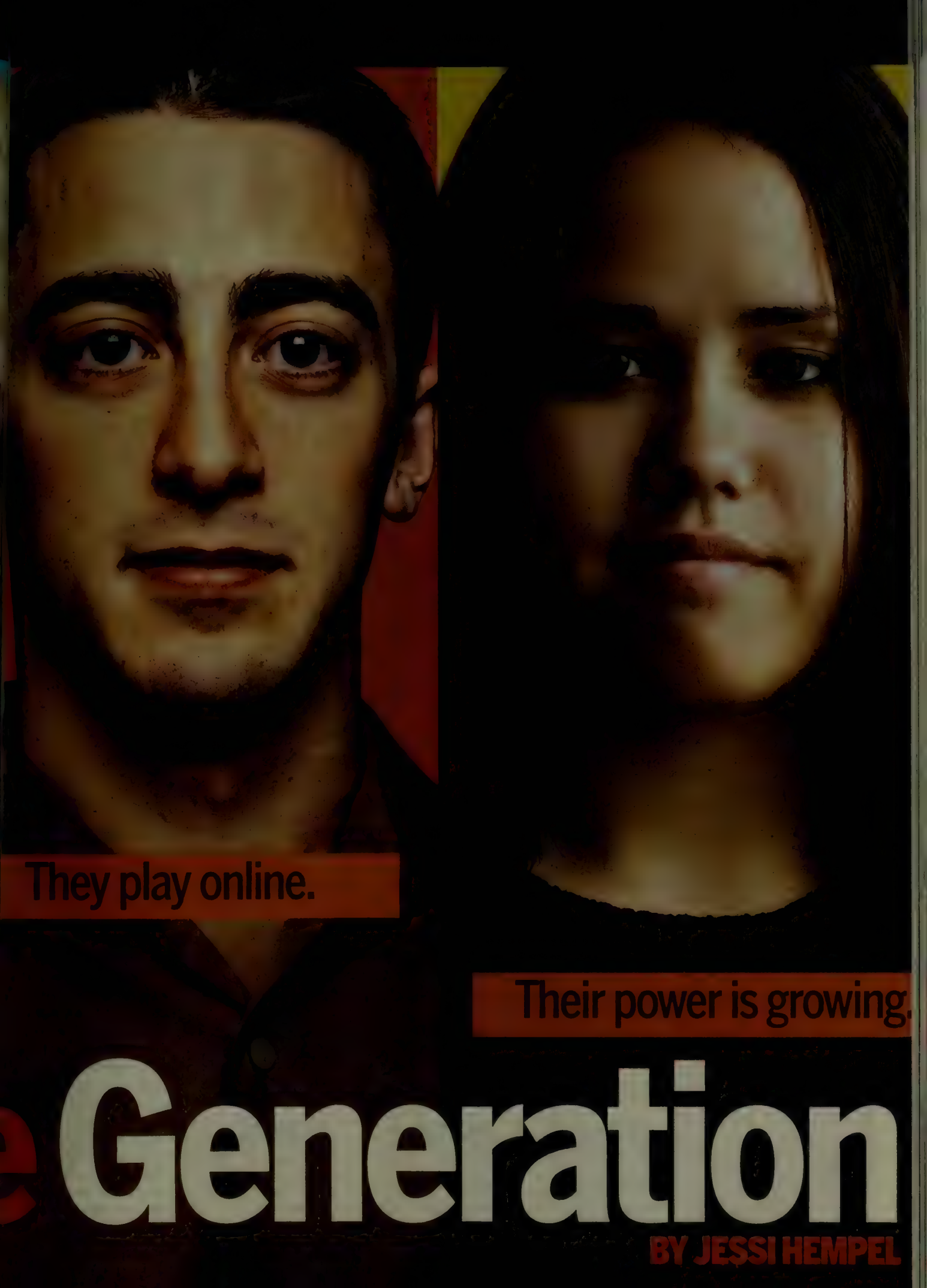


They play online.

Their power is growing.

e Generation

BY JESSI HEMPEL

THE TOADIES BROKE UP. IT WAS FOUR years ago, when Amanda Adams was 16. She drove into Dallas from suburban Plano, Tex., on a school night to hear the final two-hour set of the local rock band, which had gone national with a hit 1995 album. "Tears were streaming down my face," she recalls, a slight Texas lilt to her voice. During the long summer that followed, Adams turned to the Web in search of solace, plugging the lead singer's name into Google repeatedly until finally his new band popped up. She found it on Buzz-Oven.com, a social networking Web site for Dallas teens.

Adams jumped onto the Buzz-Oven network, posting an online self-portrait (dark hair tied back, tongue out, goofy eyes for the cam) and listing her favorite music so she could connect with other Toadies fans. Soon she was heading off to biweekly meetings at Buzz-Oven's airy loft in downtown Dallas and helping other "Buzzers" judge their favorite groups in marathon battle-of-the-bands sessions. (Buzz-Oven.com promotes the winners.) At her school, Frisco High—and at malls and concerts—she passed out free Buzz-Oven sampler CDs plastered with a large logo from Coca-Cola Inc., which backs the site in the hope of reaching more teens on their home turf. Adams also brought dozens of friends to the concerts Buzz-Oven sponsored every few months. "It was cool, something I could brag about," says Adams, now 20 and still an active Buzzer.

Now that Adams is a junior at the University of North Texas at Denton, she's online more than ever. It's 7 p.m. on a recent Saturday, and she has just sweated her way through an online quiz for her advertising management class. (The quiz was "totally out of control," write classmates on a school message board minutes later.) She checks a friend's blog entry on MySpace.com to find out where a party will be that night. Then she starts an Instant Messenger (IM) conversation about the evening's plans with a few pals.

KIDS, BANDS, COCA-COLA

AT THE SAME TIME, her boyfriend IMs her a retail store link to see a new PC he just bought, and she starts chatting with him. She's also postering for the next Buzz-Oven concert by tacking the flier on various friends' MySpace profiles, and she's updating her own blog on Xanga.com, another social network she uses mostly to post photos. The TV is set to TBS, which plays a steady stream of reruns like *Friends* and *Seinfeld*—Adams has a TV in her bedroom as well as in the living room—but she keeps the volume turned down so she can listen to iTunes over her computer speakers. Simultaneously, she's chatting with dorm mate Carrie Clark, 20, who's doing pretty much the same thing from a laptop on her bed.

You have just entered the world of what you might call Generation @. Being online, being a Buzzer, is a way of life for Adams and 3,000-odd Dallas-area youth, just as it is for millions of young Americans across the country. And increasingly, social networks are their medium. As the first cohort to grow up fully wired and technologically fluent, today's teens and twentysomethings are flocking to Web sites like Buzz-Oven as a way to establish their social identities. Here you can get a fast pass to the hip music scene, which carries a hefty amount of social currency offline. It's where you go when you need a friend to nurse you through a breakup, a mentor to tutor you on your calculus homework, and address for the party everyone is going to. For a giant brand like Coke, these networks also offer a direct pipeline to the thirsty but fickle youth market.

Preeminent among these virtual hangouts is MySpace.com, whose membership has nearly quadrupled since January alone, to 40 million members. Youngsters log on so obsessively that MySpace ranked No. 15 on the entire U.S. Internet

Can't Find America's Youth? LOL

[illegible] of 24 million U.S. teens [illegible]

87% Use the Internet	**65%** Instant message (IM)	**44%** Go online every day
29% Keep several IM conversations going at once	**29%** Have more than 50 "buddies" on regular IM list	**25%** IM people in the same room

Data: Pew Internet & American Life Project

-Oven band tryouts at Club Clearview in Dallas, Aug. 21. Clockwise from left: Two buzzers, Ziemer, Amanda Adams, founder Aden Holt, a competing guitarist, Michael Henry

terms of page hits in October, according to Nielsen//NetRatgs. Millions also hang out at other up-and-coming networks ich as Facebook.com, which connects college students, and anga.com, an agglomeration of shared blogs. A second tier of me 300 smaller sites, such as Buzz-Oven, Classface.com, and hotobucket.com, operate under—and often inside or next to—e larger ones.

Although networks are still in their infancy, experts think ey're already creating new forms of social behavior that blur the istinctions between online and real-world interactions. In fact, day's young generation largely ignores the difference. Most dults see the Web as a supplement to their daily lives. They tap to information, buy books or send flowers, exchange apartents, or link up with others who share passions for dogs, say, or pera. But for the most part, their social lives remain rooted in e traditional phone call and face-to-face interaction.

The MySpace generation, by contrast, lives comfortably in oth worlds at once. Increasingly, America's middle- and upperass youth use social networks as virtual community centers, a lace to go and sit for a while (sometimes hours). While older lks come and go for a task, Adams and her social circle are just s likely to socialize online as off. This is partly a function of how uch more comfortable young people are on the Web: Fully 87% f 12- to 17-year-olds use the Internet, vs. two-thirds of adults, acording to the Pew Internet & American Life Project.

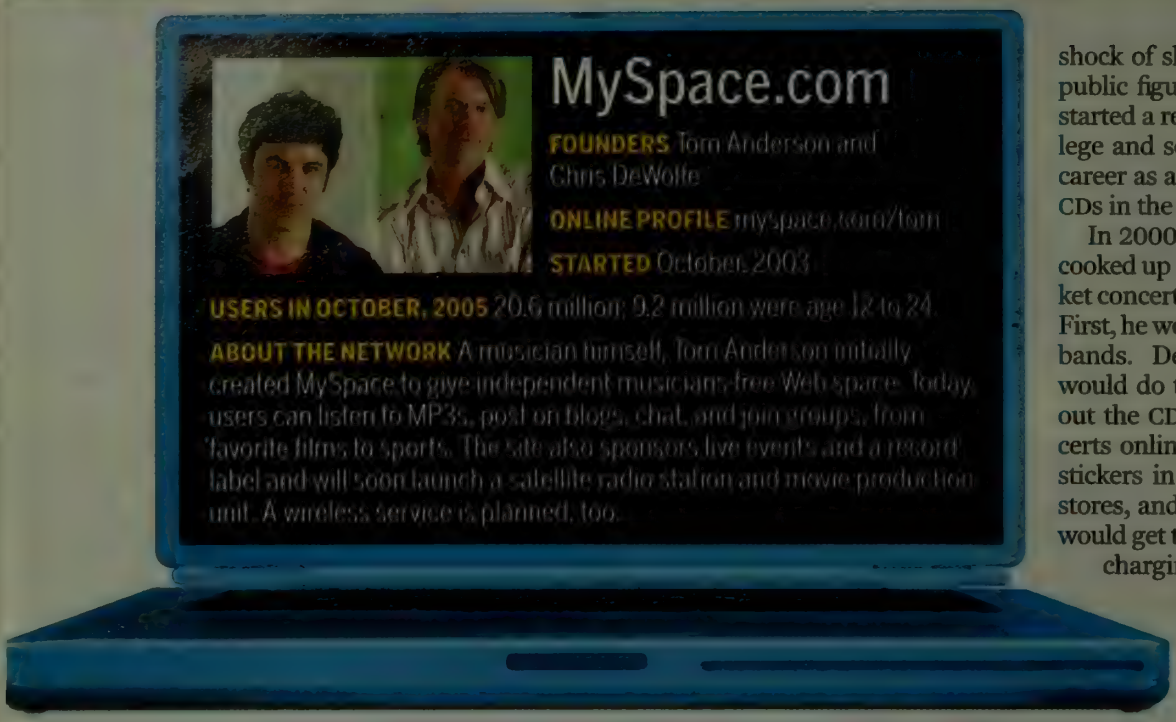
Teens also use many forms of media simultaneously. Fifteen- eighteen-year-olds average nearly 6½ hours a day watching TV, laying video games, and surfing the Net, according to a recent Kaiser Family Foundation survey. A quarter of that time, they're multitasking. The biggest increase: computer use for activities such as social networking, which has soared nearly threefold since 2000, to 1 hour and 22 minutes a day on average.

Aside from annoying side effects like hyperdistractibility, there are some real perils with underage teens and their open-book online lives. In a few recent cases, online predators have led kids into dangerous, real-life situations, and parents' eyes are being opened to their kids' new world (page 96).

ONE-HIT WONDERS

MEANWHILE, THE PHENOMENON of these exploding networks has companies clamoring to be a part of the new social landscape. News Corp. Chief Executive Rupert Murdoch has spent $1.3 billion on Web acquisitions so far to better reach this coveted demographic—$580 million alone for the July purchase of MySpace parent Intermix Media. And Silicon Valley venture capitalists such as Accel Partners and Redpoint Ventures are pouring millions into Facebook and other social networks. What's not yet clear is whether this is a dot-com era replay, with established companies and investors sinking huge sums into fast-growth startups with no viable business models. Facebook, barely a year old and run by a 21-year-old student on leave from Harvard, has a staff of 50 and venture capital—but no profits.

Still, consumer companies such as Coke, Apple Computer, and Procter & Gamble are making a relatively low-cost bet by experimenting with networks to launch products and to embed their



MySpace.com

FOUNDERS Tom Anderson and Chris DeWolfe

ONLINE PROFILE myspace.com/tom

STARTED October 2003

USERS IN OCTOBER, 2005 20.6 million; 9.2 million were age 12 to 24.

ABOUT THE NETWORK A musician himself, Tom Anderson initially created MySpace to give independent musicians free Web space. Today, users can listen to MP3s, post on blogs, chat, and join groups, from favorite films to sports. The site also sponsors live events and a record label and will soon launch a satellite radio station and movie production unit. A wireless service is planned, too.

brands in the minds of hard-to-reach teens. So far, no solid format has emerged, partly because youth networks are difficult for companies to tap into. They're also easy to fall out of favor with: While Coke, Sony Pictures Digital, and Apple have succeeded with MySpace, Buzz-Oven, and other sites, P&G's attempt to create an independent network around a body spray, for one, has faltered so far.

Many youth networks are evanescent, in any case. Like one-hit wonder the Baha Men (*Who Let the Dogs Out*) and last year's peasant skirts, they can evaporate as quickly as they appear. But young consumers may follow brands offline—if companies can figure out how to talk to youths in their online vernacular. Major companies should be exploring this new medium, since networks transmit marketing messages "person-to-person, which is more credible," says David Rich Bell, a marketing professor at the University of Pennsylvania's Wharton School.

So far, though, marketers have had little luck creating these networks from scratch. Instead, the connections have to bubble up from those who use them. To understand how such networks get started, share a blue-cheese burger at the Meridian Room, a dive bar in downtown Dallas, with Buzz-Oven founder Aden Holt. At 6 feet 9 inches, with one blue eye, one brown one, and a shock of shaggy red hair, Holt is a sort public figure in the local music scene. I started a record label his senior year at co lege and soon turned his avocation into career as a music promoter, putting out CDs in the decade that followed.

In 2000, as Internet access spread, He cooked up Buzz-Oven as a new way to ma ket concerts. His business plan was simp First, he would produce sample CDs of loc bands. Dedicated Buzzers like Adam would do the volunteer marketing, givi out the CDs for free, chatting up the co certs online, and slapping up posters an stickers in school bathrooms, local mus stores, and on telephone poles. Then He would get the bands to put on a live conce charging them $10 for every fan h turned out. But to make the ide work, Holt needed capital produce the free CDs. One his bands had recently done show sponsored by Coke, an after asking around, he found the marketer's company's Dalla sales office. He called for an appointment. And then he calle again. And again.

Coke's people didn't get back to him for weeks, and then h was offered only a brief appointment. With plenty of time to pra tice his sales pitch, Holt spit out his idea in one breath: Marke ing through social networks was still an experiment, but it wa worth a small investment to try reaching teens through virtu word of mouth. Coke rep Julie Bowyer thought the idea ha promise. Besides, Holt's request was tiny compared with the mi lions Coke regularly sinks into campaigns. So she wrote him check on the spot.

DEEP CONNECTIONS

BY THE TIME BEN LAWSON became head of Coke's Dallas sale office in 2001, Buzz-Oven had mushroomed into a nexus that a lowed hundreds of Dallas-area teens to talk to one another an socialize, online and off. A middle-aged father of two teens hin self, Lawson spent a good deal of time poring over data abou how best to reach youth like Adams. He knew what Buzzer Mik Ziemer, 20, so clearly articulates: "Kids don't buy stuff becaus

PLAYBOOK: BEST-PRACTICE IDEAS

Yo, what r u doin online?

More marketers are learning how to reach young folks through online social networks:

APPLE After college student members of Facebook.com formed their own Apple-lovers group, the site invited the computer maker to sponsor them. Now, users who join Apple Students can enter weekly contests for iPod shuffles, discuss Apple products, follow links to Apple's student discount program, and find other Apple lovers.

WALT DISNEY To promote *The Hitchhiker's Guide to the Galaxy* last spring, Touchstone Pictures set up blogs on Xanga.com for the movie's main characters. Users could subscribe to read postings and add in their own. The site garnered about 5,000 subscribers and some 220,000 page views overall.

TARGET The retailer has sponsored a group on MySpace.com that features a 15-year-old professional snow- and skateboarder Shaun White. Users can watch a video of him (a Target logo on his helmet), discuss his exploits, or click on the "Shop" button. More than 31,000 users have joined the group, called Kickfliplivin.

COCA-COLA In addition to its Buzz-Oven presence, the company has sponsored a Sprite profile on MySpace.com in which "Sprite" is a hip-hop dancer. Users can link to Sprite, play with a hip-hop language translator, watch videos for dance lessons, and enter a contest. Nearly 22,875 people have linked to Sprite. 520 have left comments.

Data: BusinessWee

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they see a magazine ad. They buy stuff because other kids tell them to."

What Lawson really likes about Buzz-Oven is how deeply it weaves into teens' lives. Sure, the network reaches only a small niche. But Buzzers have created an authentic community, and Coke has been welcomed as part of the group. At a recent dinner, founder Holt asked a few Buzzers their opinions about the company. "I don't know if they care about the music or they just want their name on it, but knowing they're involved helps," says Michael Henry, 19. "I know they care; they think what we're doing is cool," says Michele Barr, 21. Adds Adams: "They let us do our thing. They don't censor what we do."

Words to live by for a marketer, figures Lawson, particularly since Coke pays Buzz-Oven less than $70,000 a year. In late October, Holt signed a new contract with Coke to help him launch Buzz-Oven Austin in February. The amount is confidential, but he says it's enough for 10,000 CDs, three to four months of street promotions, and 50,000 fliers, plus some radio and print ads and a Web site promotion. Meanwhile, Buzz-Oven is building relations with other brands such as the *Dallas Observer* newspaper and McDonald's Chipotle restaurants, which kicks in free food for Buzzer volunteers who promote the shows. Profits from ticket sales are small but growing, says Holt.

Not so long ago, behemoth MySpace was this tiny. Tom Anderson, a Santa Monica (Calif.) musician with a film degree, partnered with former Xdrive Inc. marketer Chris DeWolfe to create a Web site where musicians could post their music and fans could chat about it. Anderson knew music a film; De Wolfe knew the Internet business. A derson cajoled Hollywood friends—musicia models, actors—to join his online communi and soon the news spread. A year later, ever one from Hollywood teen queen Hilary Duff Plano (Tex.) teen queen Adams has an accou

It's becoming a phenomenon unto itse With 20 million of its members logging on October, MySpace now draws so much traf that it accounted for 10% of all advertisemen viewed online in the month. This is all t more amazing because MySpace doesn't allo those ubiquitous pop-up ads that block yo view, much less spyware, which monitors wh you watch and infuses it with pop-ups. In fac the advertising can be so subtle that kids dor distinguish it from content. "It's what o users want," says Anderson.

As MySpace has exploded, Anderson h struggled to maintain the intimate atmosphe that lends social networks their authenticit When new users join, Tom becomes their fr friend and invites them to send him a messag When they do, they hear right back, from hi or from the one-quarter of MySpace's 16 staffers who handle customer service. Ask Adams what sh thinks of MySpace's recent acquisition by News Corp., and sh replies that she doesn't blame "Tom" for selling, she would hav done the same thing. She's talking about Anderson, but it's har to tell at first because she refers to him so casually, as if he we someone she has known for years.

That's why Murdoch has vowed not to wrest creative co trol from Anderson and DeWolfe. Instead News Corp.'s r sources will help them nourish new MySpac dreams. Earlier this month they launched record label. In the next few months, the du says, they will launch a movie productio unit and a satellite radio station. By Marc they hope to venture into wireless technolo gy, perhaps even starting a wireless compan to compete with Virgin Mobile or Sprin Nextel's Boost. Says DeWolfe: "We want t be a lifestyle brand."

It's proof that a network—and its advertis ing—can take off if it gives kids something the badly want. Last spring, Facebook founde Mark Zuckerberg noticed that the college stu dents who make up most of his 9.5 millio members were starting groups with names lik Apple Students, where they swapped informa tion about how to use their Macs. So he asked Apple if it wanted to form an official group Now—for a fee neither company will disclose— Apple sponsors the group, giving away iPo Shuffles in weekly contests, making produc announcements, and providing links to its student discount program.

The idea worked so well that Facebook began helping anyone wh wanted to start a group. Today there are more than a dozen, including several sponsored by advertisers such as Victoria's Secret and Elec-

Teen Wallets Are Bulging

$175 BILLION
Estimated teen consumer spending market

$200 BILLION
Estimated college student consumer spending market

33%
Percentage of high school seniors with a credit card

Data: Alloy Media + Marketing

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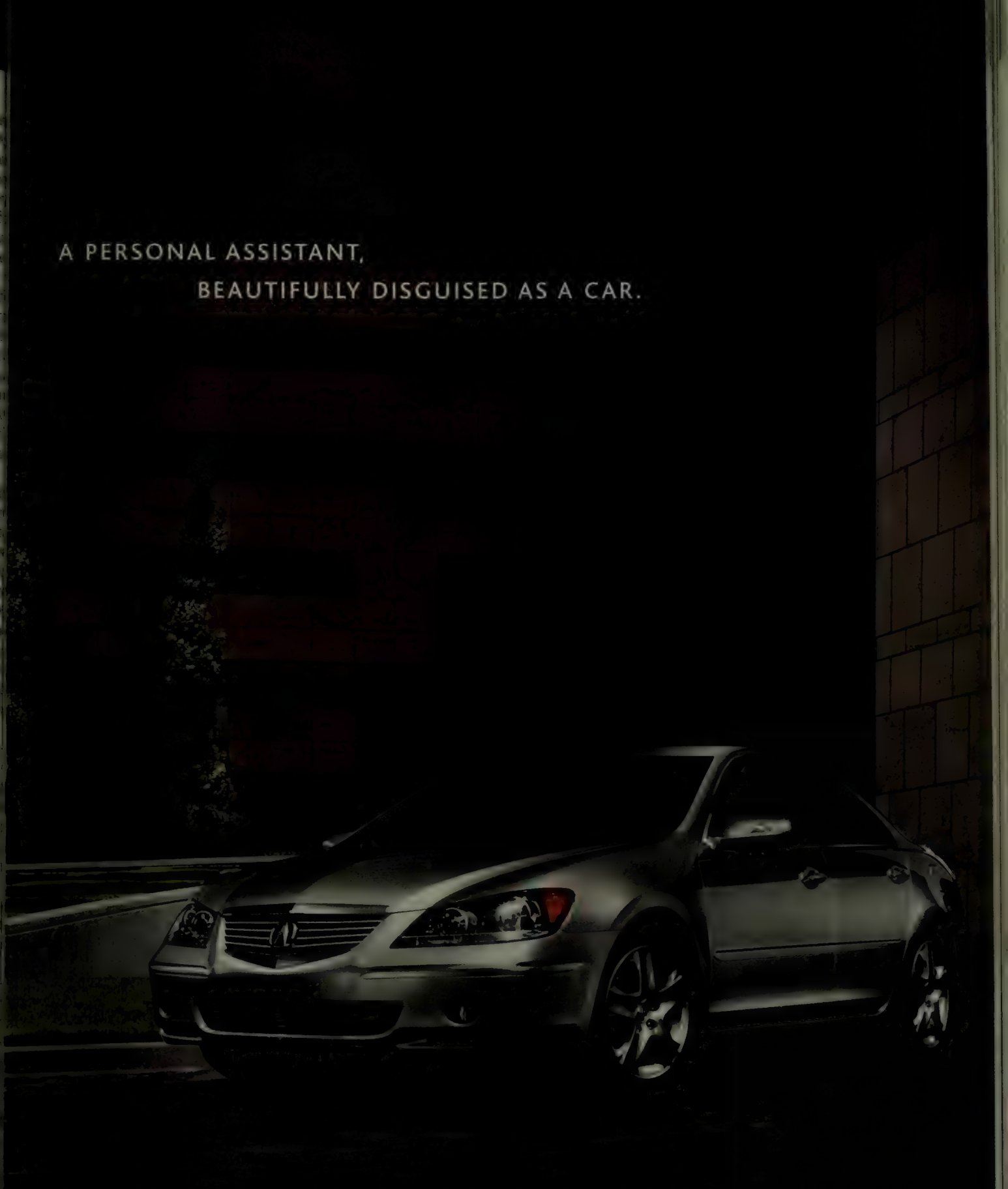

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tronic Arts. Zuckerberg soon realized that undergrads are more likely to respond to a peer group of Apple users than to the traditional banner ads, which he hopes to eventually phase out. Another of his innovations: ads targeted at students of a specific college. They're a way for a local restaurant or travel agency to advertise. Called Facebook Announcements, it's all automated, so anyone can go onto Facebook, pay $14 a day, and fill out an ad.

SPARKLE AND FIZZLE

STILL, SOCIAL NETWORKS' relations with companies remain uneasy. Last year, for example, Buzz-Oven was nearly thrown off track when a band called Flickerstick wanted to post a song called *Teenage Dope Fiend* on the network. Holt told Buzzers: "Well, you can't use that song. I'd be encouraging teenagers to try drugs." They saw his point, and several Buzzers persuaded the band to offer up a different song. But such potential conflicts are one way, Holt concedes, that Buzz-Oven's corporate sponsorships could come to a halt.

Like Holt, other network founders have dealt with such conflicts by turning to their users for advice. Xanga co-founder John Hiler has resisted intrusive forms of advertising like spyware or pop-ups, selling only the conventional banner ads. When advertisers recently demanded more space for larger ads, Hiler turned the question over to Xanga bloggers, posting links to three examples of new ads. More than 3,000 users commented pro and con, and Hiler went with the model users liked best. By involving them, Hiler kept the personal connection that many say they feel with network founders—even though Xanga's membership has expanded to 21 million.

So far, corporate advertisers have had little luck creating such relationships on their own. In May, P&G set up what it hoped would become a social network around Sparkle Body Spray, aimed at tweens. The site features chatty messages from fake characters named for scents like Rose and Vanilla ("Friends call me Van"). Virtually no one joined, and no entries have comments from real users. "There wasn't a lot of interesting content to engage people," says Anastasia Goodstein, who documents the intersection between companies and the MySpace Generation at Ypulse.com. P&G concedes that the site is an experiment, and the company has found more success with a body-spray network embedded in MySpace.com.

The most basic threat to networks may be the whims of their users, who after all are mostly still kids. Take Friendster, the first networking Web site to gain national attention. It erupted in 2003, going from a few thousand users to nearly 20 million. But the company couldn't keep up, causing frustration among users when the site grew sluggish and prone to crash. It also started with no music, no message boards or classifieds, no blogging. Many jumped ship when MySpace came along, offering the ability to post song tracks and more elaborate profiles. Friendster has been hustling to get back into the game, adding in new options. But only 942,000 people clicked on the site in October, vs. 20.6 million who clicked on MySpace in the same time.

That's the elusive nature of trends and fads, and it poses a challenge for networks large and small. MySpace became a threat to tiny Buzz-Oven last year when Buzzers found they could do more cool things there, from blogs to more music and better profile options. Buzzer message board traffic slowed to a crawl. To stop the hemorrhaging, Holt joined MySpace himself and set up a profile for Buzz-Oven. His network now operates both independently and as a subsite on MySpace, but it still works. Most of Holt's Dallas crowd came back, and Buzz-Oven is up to 3,604 MySpace members now, slightly more than when it was a stand-alone network.

Even if the new approach works, Holt faces a succession issue that's likely to hit other networks at some point. At 35, he's well past the age of his users. Even the friends who helped him launch Buzz-Oven.com are in their late 20s—ancient to members of his target demographic. So either he raises the age of the group—or replaces himself with someone younger. He's trying the latter, betting on Mike Ziemer, the 20-year-old recent member, even giving him a small amount of cash.

Ziemer, it turns out, is an influencer. That means record labels and clothing brands pay him to talk up their products, for which he pulls down several hundred dollars a month. Ziemer has spiky

Wired Kids: Keeping Them Safe—and Keeping Pace

School Up on Social Networks: A list of resources for learning more about how to educate and protect teens online

Track the MySpace Generation: Trendspotter Anastasia Goodstein runs the it-blog for marketers and the media to stay in touch with teens

Get the Story Behind the Story: For a podcast interview with Staff Editor Jessi Hempel by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

BusinessWeek online
www.businessweek.com/extras

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brown hair and a round, expressive face. In his MySpace profile he lists his interests in this order: Girls. Music. Friends. Movies. He has 4,973 "friends" on MySpace. At all times, he carries a T-Mobile Sidekick, which he uses to text message, e-mail, and send photos to his friends. Sometimes he also talks on it, but not often. "I hate the phone," he says.

Think of Ziemer as Aden Holt 2.0. Like Amanda Adams, he's also a student at UT-Denton. When he moved to the area from Southern California last year, he started Third String PR, a miniature version of Buzz-Oven that brings bands to the 'burbs. He uses MySpace.com to promote bands and chats online with potential concertgoers. Ziemer can pack a church basement with tweens for a concert, even though they aren't old enough to drive. On the one hand, Ziemer idolizes Holt, who has a larger version of Ziemer's company and a ton of connections in the music industry. On the other hand, Ziemer thinks Holt is old. "Have you ever tried to talk with him over IM?" he says. "He's just no plugged in enough."

Exactly why Holt wants Ziemer on Buzz-Oven. He know the younger entrepreneur can tap a new wave of kids—an keep the site's corporate sponsor on board. But he worries tha Ziemer doesn't have the people skills. What's more, shoul Ziemer lose patience with Buzz-Oven, he could blacklist Hol by telling his 9,217 virtual friends that Buzz-Oven is no longe cool. In the online world, one powerfully networked perso can have a devastatingly large impact on a small society lik Buzz-Oven.

For now, the gamble is paying off. Attendance is up at Buzz Oven events, and if the Austin launch goes smoothly, Holt wil be one step closer to his dream of going national. But given th fluid world of networks, he's taking nothing for granted. ■

–With Paula Lehman in New Yor

Protecting Your Kids From Cyber-Predators

It's a parent's nightmare: A 16-year-old Port Washington (N.Y.) girl was molested by a 37-year-old man in September, after they met on MySpace.com. Local police say the man misrepresented himself when he exchanged messages online with the teen. Then he showed up at the girl's after-school job, followed her to the parking lot, forced her into his car, and attacked her. The assailant, who was arrested and released on bail, knew where she worked because she had posted it on her MySpace profile, says Port Washington Police Detective Sergeant Paul Gros.

This is the dark side of teen blogging and social networking. Along with favorite bands and best friends, kids are blogging phone numbers, class schedules, and other personal information that makes them vulnerable to anyone who wants to track them down. Across the country, law enforcement officials get some 6,000 cases a year involving teens victimized as a result of online activity, estimates Parry Aftab, a Fort Lee (N.J.) privacy lawyer who founded WiredSafety.org to help keep kids safe from cyber-criminals.

The social networks are plenty worried. Last spring, MySpace created an algorithm to identify underage users and eradicated 330,000 profiles, says Aftab. A small team of employees also reviews photographs and removes snapshots showing members topless or in offensive t-shirts. And it posts a blunt message: "If you're under 14, MySpace is not the place for you. Go away." MySpace declined to comment on the tactics, but Chief Executive Officer Chris DeWolfe says about a quarter of the company's 165 employees monitor safety through customer service.

Facebook, too, employs algorithms to remove problematic users and follows up on reports of user abuse, says general counsel Chris Kelly. Facebook college users also must have an e-mail address ending in "edu," and high school users can join only if a member invites them in. "You end up with an environment where people's profiles online are tied to their real world," says Kelly.

Many families remain in the dark about how their kids use the Net. New York parent Amy Luong had no idea her 13-year-old daughter kept a blog on Xanga.com until she got a call from her school. When Luong logged on, she was shocked. Her daughter had posted photos and her age, plus things her mom knew weren't true. "She made it sound like she was out with her friends until 1 or 2 in the morning, when I knew she had gone with her dad to a late movie," says Luong. She made her daughter remove the profile but later found she had a MySpace account despite the site's age requirement of 14.

With the ranks of teen bloggers now surpassing 4 million, Parent Teacher Associations are sending students home with guides for parents and collaborating with school administrators to hold educational meetings. Some schools are laying out new rules. One New Jersey private school has even banned online social networking for students—even at home and outside of school hours. Still, Aftab and others say it's unrealistic to expect schools or Web sites to be solely responsible for protecting kids. "MySpace is not your child's parent," she says. That's why parents need to study up on what their kids are doing on the Web.

–By Jessi Hempel

Think B4 U Click

Privacy lawyer Parry Aftab suggests these safety tips for teens online (also see wiredsafety.org):

Don't

- Post anything your parents, principal, or a predator shouldn't see.
- Set up profiles for your friends. Let them set up their own.
- Share your password or choose an obvious one. Protect your ID online.

Do

- Morph your pic (pixelate it, turn it into a sepia or black-and-white print, or a cartoon).
- Put everything behind passwords and turn off links to strangers.
- Set up a free Web-based e-mail address for your profile registration. If things go wrong, you can just close it down.

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The Final Frontier At Costco Prices

SpaceX aims to cut the frills and offer bargain satellite launches

BY STAN CROCK

GAZILLIONAIRE ELON Musk is a techie high-flier in more ways than one. On Nov. 19 the Silicon Valley phenom, who made more than $200 million before he was 32 by selling his founding stakes in PayPal Inc. and software maker Zip2 Corp., flew on his Falcon 900 jet from his home in Bel Air, Calif., to Boston to deliver a talk at Harvard Business School. The next day it was Manhattan, where he mingled with the glitterati at the opening of *Syriana*, a movie partially bankrolled by pal and former eBay executive Jeff Skoll. On Nov. 21, Musk made a brief stop in California on the way to Kwajalein Atoll in the Marshall Islands. That exotic spot, he hopes, will be the launchpad—literally—of his latest bid for glory: propelling his startup, Space Exploration Technologies Corp., into the big-bucks world of rocketry.

If SpaceX succeeds in lofting its rocket and an Air Force Academy research satellite into orbit, Musk will vindicate his vision and his investment. Financed almost entirely out of his own pocket, the company is the South Africa native's attempt to carve out a lucrative niche in the wildly expensive launch business. Musk believes that he can blast military and commercial satellites into space at Costco prices—$6.7 million for a small payload and $38 million to $78 million for a heavyweight launch. By comparison, the Air Force's total cost for a Boeing or Lockheed Martin launch of a big payload comes to about $230 million, up from an inflation-adjusted $95 million in 1998.

DELAYS, DELAYS

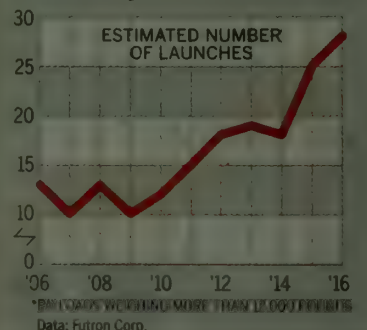
SO FAR, SATELLITE customers have rewarded Musk's optimism with $200 million in advance launch contracts. The company faces just two problems. While SpaceX, based in El Segundo, Calif., has fired off plenty of press releases, it has yet to get a rocket off the ground. Its first launch, already two years behind schedule, was scrubbed on Nov. 26 because of a balky computer and a liquid-oxygen leak from a valve inadvertently left open. The company expects to try again in mid-December.

SpaceX could face another hurdle as formidable as Earth's gravity. The Defense Dept. may soon sign off on a Boeing-Lockheed joint venture that critics fear could lock up the Air Force's $32 billion heavy-payload launch program, known as Evolved Expendable Launch Vehicles (EELV), until 2011. That would freeze SpaceX and other entrepreneurs out of a huge chunk of the military market.

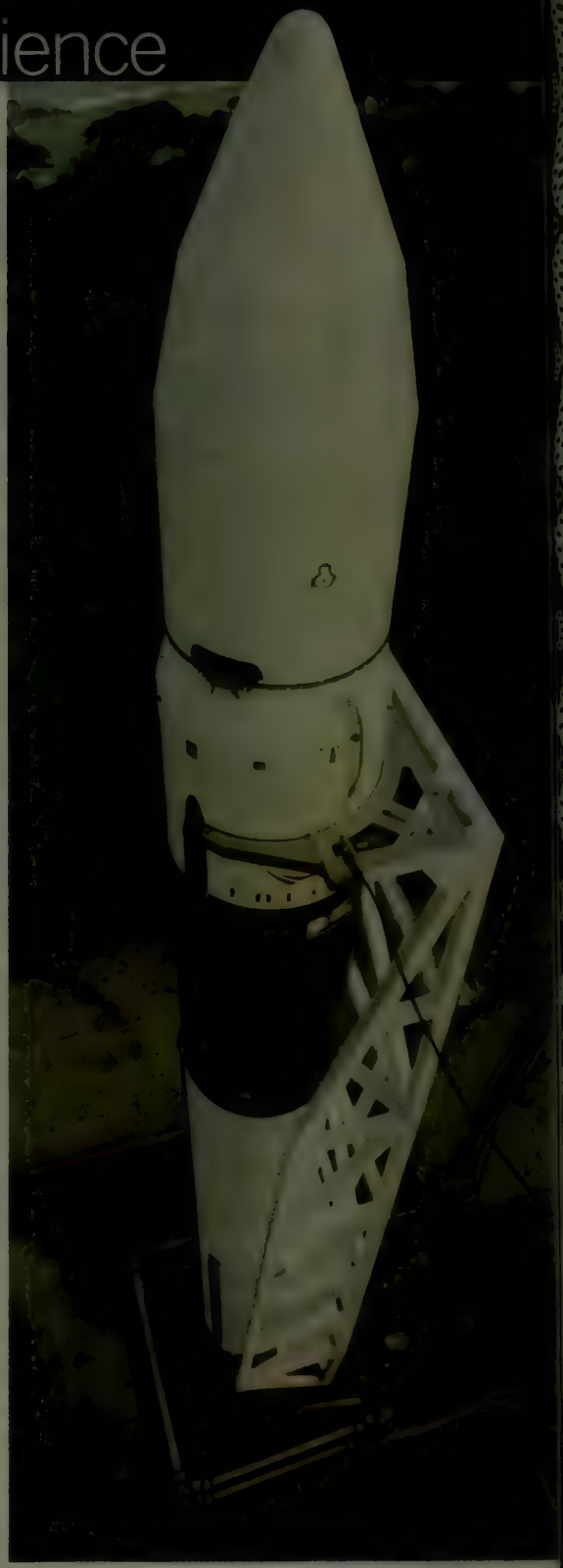
SpaceX is fighting hard to block the monopoly in the courts and at the Federal Trade Commission, which must approve the deal. But even if his outfit does not get a shot at big military satellites, Musk hopes to thrive by taking on Orbital Sciences Corp. in Dulles, Va., and the bargain-basement Russians and Ukrainians in the business of lifting smaller commercial payloads. SpaceX's under-$7 million small-payload launches cost one-third to one-half of Orbital's

BLASTING OFF

Projected launches of medium and heavy* commercial satellites



Data: Futron Corp.



ON THE PAD The first SpaceX launch is two years behind schedule

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Sciences' prices, according to data compiled by the American Institute of Aeronautics & Astronautics.

Such rock-bottom fees—and a belief in the reliability of SpaceX's gear—have attracted a range of clients, from an unidentified U.S. intelligence agency to the Malaysian government to Las Vegas-based Bigelow Aerospace. The startup is betting that companies will want to do research on the inflatable space stations it plans to put into orbit. Bigelow figures that SpaceX will work out any glitches, making its scheduled launch in 2008 a bargain worth the risk. "What Elon is doing is not a small leap," says Michael N. Gold, Bigelow's corporate counsel. "He's looking at a significant reduction in price" compared with his rivals.

MUSK Using his big PayPal payout for extraterrestrial endeavors

LIGHT YEARS AHEAD?

OVER A DOUBLE *grande latte* blended with a half-dozen packs of sugar at the Whole Foods in New York's Time Warner Center, the 34-year-old Musk explains why his blueprint isn't just blue sky. Musk, who holds business and physics degrees from the University of Pennsylvania, insists he's light years ahead of previous space startups, most of which came a cropper because of undercapitalization, a lack of engineering talent, and reliance on dodgy technology.

In contrast, Musk hired what he calls the Michael Jordans of engineering from major players such as Boeing Co. and TRW Inc. Musk—a risk-taker who boasts of having driven his McLaren F1 sports car at 215 mph on an airport runway—has plowed $100 million of his own money into the company, supplemented by smaller investments from friends and relatives. That cushion, he says, gives SpaceX the reserves to withstand three launch failures.

SpaceX has yet to launch—but it has a blue-ribbon engineering staff

Musk says he has overcome many technical hurdles by simplifying launch hardware. For example, SpaceX uses the same engine on all its stages instead of different units. Its electronics are on chips instead of circuit boards, which reduces wiring glitches. To slice costs, most SpaceX rocket stages are reusable instead of expendable. And SpaceX intends to save money by recovering sections from the ocean instead of rebuilding an entire rocket. Musk also brought a Silicon Valley business model to Southern California, forming a small, innovative, 150-employee company, a sharp contrast to the bureaucratic legions who toil on launches for Boeing and Lockheed Martin Corp. In an age of outsourcing, SpaceX makes its engines and boosters in-house to avoid high-priced suppliers such as Pratt & Whitney, General Electric, and Rolls-Royce. If he used those manufacturers' components, Musk says, he would be trapped in "the high-cost culture of the space industry."

Musk's game plan has its skeptics. "Reductions in launch costs have proven remarkably elusive over the last half-century," notes John E. Pike, director of globalsecurity.org, an Alexandria (Va.) think tank. But others think SpaceX has a chance. John R. London III, assistant for project management and development at NASA's Marshall Space Flight Center in Huntsville, Ala., is impressed by the quality of the people SpaceX has hired. "I think they will ultimately be successful," London says. As for problems with the launch at Kwajalein, London is unfazed. "This is not an unusual kind of thing you see when developing new launch systems," he says.

But SpaceX fears it may not get a chance to offer the government its bargain blastoffs. T block the Boein Lockheed Mart joint venture, t company is spendi as much time in t courtroom as in t cleanroom. Whi SpaceX lost its fi court challenge, t opposition apparen ly compelled the A Force to back off i plan, laid out in an i ternal memo, to sh out everyone but t two giants f launches throug 2011. Instead, the A Force told the Cou of Federal Claims i Washington it woul dole out contrac only through 200 and delay awardin later lifts. SpaceX slated to launch a sp satellite on an EELV class booster in earl 2007—thus qualif ing to compete for EELV launches in 200 and later years.

Even then, Boeing and Lockheed Ma tin will have a competitive edge: The A Force is footing the bill for their infr structure costs. The service argues that needs to subsidize the giants in the wak of the collapse of the commercial launc market to ensure that it has at least tw options for lifting its vital payloads. Bu the huge increase in launch costs is draw ing fire from Capitol Hill.

The Air Force's strategy seems particu larly clumsy now that demand for com mercial launches is poised to bounc back. Aerospace consultant Futron Corp in Bethesda, Md., predicts that the num ber of commercial launches will double i the next decade.

For Musk, beating the big guys out o a share of the launch market is just th start. His ultimate goal is to turn every one into a highflier by making launche so cheap, easy, and common that hu mans will become, in his words, " space-faring, multiplanet species. Musk wants to colonize Mars as a back up planet because Earth is vulnerable t manmade and natural disasters. Beach front property on the Red Planet Maybe someday. But first, Musk has t get off the beach at Kwajalein and show the doubters that his rockets can soar a high as his rhetoric. ■

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ManU Gets Kicked In the Head–Again

Losing Vodafone's sponsorship is yet another blow to owner Malcolm Glazer

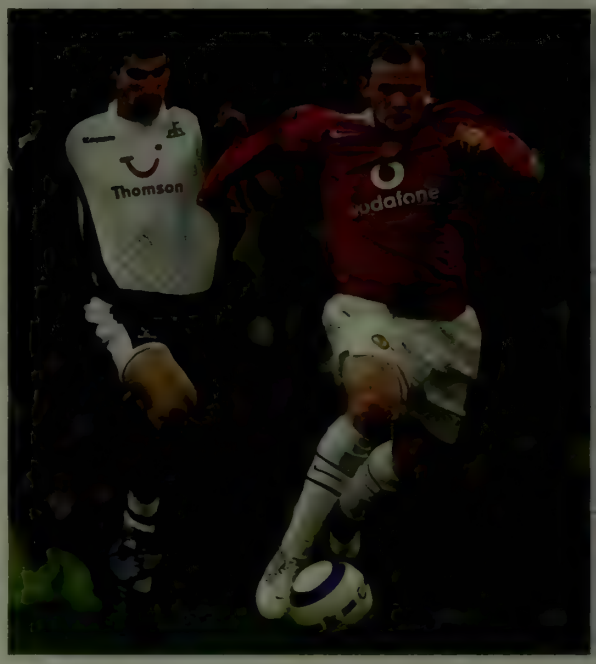
BY LAURA COHN AND STANLEY HOLMES

IT'S EARLY IN THE GAME, BUT Malcolm Glazer is already down a few goals. Glazer, the American sports tycoon who took control of British soccer team Manchester United last May, has suffered a series of setbacks in recent weeks that threaten to undermine his ambitions of raising the club's global presence. The once-dominant ManU is struggling on the field for the second season in a row, falling far behind rival Chelsea in its bid to finish first in its league. Then, on Nov. 18, star midfielder Roy Keane, ManU's captain, bolted. Now, Vodafone, which pays $16 million a year to splash its name across players' bright-red jerseys, has pulled out of its sponsorship deal two years early.

Owning Britain's most celebrated soccer team has become a growing headache for the 77-year-old Glazer, a reclusive billionaire best known for his U.S. football team the Tampa Bay Buccaneers. The loss of Vodafone Group PLC has dealt Glazer, who gained control of the team in a $1.47 billion takeover, a particularly harsh and unexpected blow. Now he must replace the Vodafone cash he'd been counting on to help him service the $490 million in loans and $509 million in preferred securities he issued when he took over. "Glazer is under more pressure than ever," says Allyson Stewart-Allen, a director at International Marketing Partners Ltd. in London.

Vodafone's decision to walk is also a public-relations nightmare for a team that is already dealing with growing ranks of disgruntled fans. Vodafone isn't talking, but sources say the company retreated to focus on a deal with broader appeal—its new three-year sponsorship of the pan-European UEFA Champions League. Vodafone has a history of backing out when its teams start to falter. In 2004 the company stopped sponsoring Australia's rugby team after it lost to England in the Rugby World Cup.

Now Glazer and three of his sons, who sit on ManU's board, must find another deal. Vodafone put in about 5% of the team's annual revenues of $300 million.



OFF THEIR BACKS The shirt deal was 5% of the team's revenues

ManU sources expect 2006 operating earnings of about $99 million, up from $83 million this year. But given ManU's recent setbacks, "it will be difficult to get there," says San Datta, a director at Hermes Sports Partners, a London corporate finance adviser that specializes in the European sports market.

Although Glazer declined comment, team executives insist they'll soon line up another strong sponsorship. "There are not many sports properties that have the global appeal of Manchester Unite says ManU commercial director Andy A son. A number of Asian companies ha already approached the club about a sh deal or other sponsorship. Compani from China, where ManU says it has million fans, are especially keen. Wh talks are still in early stages, one possib ity is a sponsorship involving Mac Island and its gaming industry.

MISSING THE CUT

EVEN SO, UNLESS THE team's perfor ance improves, it will hit another financ snag. If ManU loses a Dec. 7 mat against Portugal's Benfica in Lisbon, will fail to qualify for the so-called knoc out round of the Champions League f the first time in a decade. That means t Glazers will miss out on lucrative TV re enues worth as much as $10 million, sa Phil Carling, global head of football sports marketing agency Octagon London. Says Carling: "This is incon that goes straight to the bottom line."

The Glazer family is taking big steps shore up the club's financials. They've c more than 20 staff members, includin some executives. They also plan to rais ticket prices 9% next year, and they hav O.K.'d lending 23 players to other clubs saving ManU more than $20 million i fees and salaries. "They are cutting ex penses everywhere they can," says Jeffre Bliss, president of Javelin Group, a Wash ington sports marketing firm that special izes in soccer. That makes business sense but it could be tough to build ManU' brand image and rein in costs, too. Bein the boss of a British soccer team is a lo rougher than Glazer ever imagined. ■

Why Glazer is in a Sweat

SPONSORSHIP WOES
Vodafone ended its $16 million-a-year deal to put its name on ManU's jerseys two years early

BROADCAST REVENUES AT RISK
The team could lose $10 million in TV revenues if it is defeated by Benfica in Portugal on Dec. 7

LEADERSHIP GAP
The defection of team captain Roy Keane hurt morale

TALENT SQUEEZE
ManU must compete with deep-pocketed rival Chelsea for top-ranked players

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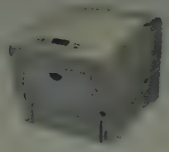
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Cancer Cells with A Death Wish

Is Abbott Labs' Stephen Fesik closing in on a way to make them self-destruct?

BY MICHAEL ARNDT

INSIDE THE LABORATORIES OF the pharmaceutical industry, where even entry-level jobs can require an advanced degree, extraordinary talents often seem ordinary. Still, Stephen W. Fesik stands out. After joining Abbott Laboratories in 1983, fresh from completing postdoctoral work in nuclear magnetic resonance (NMR) at Yale University, Fesik accomplished more in 13 years than many researchers do in a lifetime. Using an MRI-like device that reveals the atomic structure of molecules in three dimensions, Fesik perfected and patented a technique that Abbott and other drugmakers use to create medications.

Now, as divisional vice-president for cancer research, the 52-year-old Fesik is trying to top his own achievement—this time in the area of cancer. His goal is to flick on a cellular switch that should cause tumor cells to kill themselves. It's a trick that has stumped scientists for decades. And with no formal training in cancer research, Fesik at first seems an unlikely candidate to achieve it. His experimental compound is just entering the first phase of clinical trials. Now he and his research team must prove through years of tests on animals and humans that it is safe and effective. "We're attempting to do things that have never been done before," says Daniel W. Norbeck, vice-president of global pharmaceutical research at Abbott. "This is risk piled on risk."

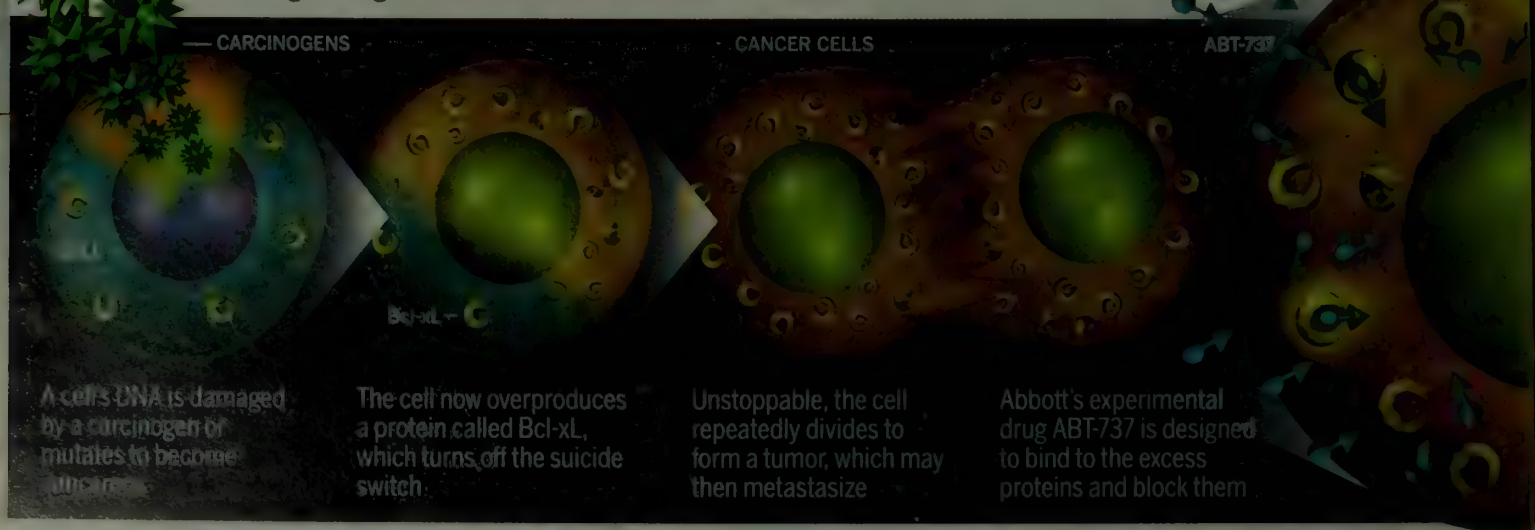
Fesik's approach capitalizes on the natural tendency of cells to self-destruct when they become damaged or drift into a part of the body where they don't belong. This suicide mechanism, called apoptosis, malfunctions in cancer cells, allowing them to spread and form tumors. The culprit is a protein that runs amok, block the apoptosis process. In a quest that to years in the lab, Fesik scanned 20,000 m lecular fragments until he found two t snugly attach themselves to the prote turning the death toggle back on. In te on lab animals, Fesik's compound, co named ABT-737, helped kill lympho and small-cell lung cancer cells. "It's solutely the right way to go," says Dr. G ard I. Evan, a professor of cancer biolog the University of California in San Fra cisco. "Fesik is leading the pack."

BIG-TIME COMPETITION

THERE IS NO QUESTION that Abb needs ABT-737 to be a hit. The No Chicago (Ill.) company, which is on tra to post 2005 sales of $22.3 billion, is fu neling much of its $1.75 billion resear budget into oncology—a new and pote tially huge market for the company. B Abbott's first try at developing a canc drug ended embarrassingly. On Oct. the Food & Drug Administration reject the product, Xinlay, after it failed to slo advanced-stage prostate cancer. A though Abbott has grown through acq sitions and licensing deals, it hasn't pr duced a blockbuster of any kind from own labs since 2000, when it introduc Kaletra to combat HIV. "They have n proven at all that they have a competen in R&D," says Matthew J. Dodds, an equ ty analyst with Citigroup

Abbott also has big-time competitio including Pfizer Inc., which earlier th year acquired Idun Pharmaceuticals Inc. San Diego biotech lab. Idun was c founded by H. Robert Horvitz, a biolog professor at Massachusetts Institute

CELLULAR HARA-KIRI Most cells commit suicide if they become damaged in such a way that they may pose a threat to the organism. In cancer cells, this switch gets turned off, allowing tumors to grow and grow. Abbott is testing a drug to turn the switch back on.



A cell's DNA is damaged by a carcinogen or mutates to become cancerous

The cell now overproduces a protein called Bcl-xL, which turns off the suicide switch

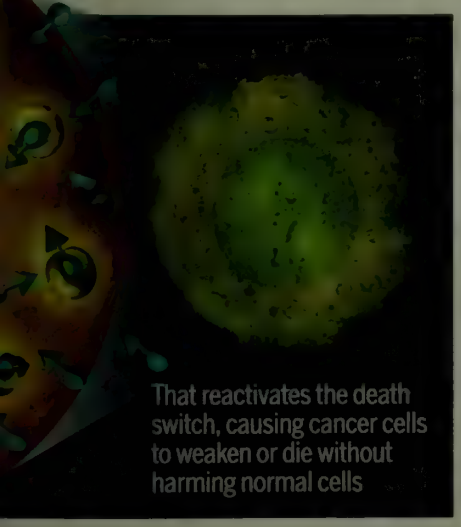
Unstoppable, the cell repeatedly divides to form a tumor, which may then metastasize

Abbott's experimental drug ABT-737 is designed to bind to the excess proteins and block them

FESIK His ABT-737 could end an innovation dry spell for Abbott

chnology who n the Nobel ize in Medicine 2002 for his dis- veries in apopto- . Indeed, more than 40 companies are lving into this strategy for treating can- r, reports BioSeeker Group, a Stockholm otech and pharmaceutical research firm. At another employer, Fesik might nev- have been considered for such a critical signment. In his previous job as chief of MR research, he mapped the molecular ucture and shape of compounds to lp drug developers find promising ds. A self-described nerd, he also holds PhD in medicinal chemistry from the iversity of Connecticut School of Phar- acy. But he has no medical background, r has he ever managed the animal trials at are key first steps in drug develop- ent. So when he was offered his current sition in 2000, he hesitated. "I had a shy job, frankly," he says. "I was good it. People knew me." After a month of lking it over with his wife, Lauren, and entors at Abbott, he jumped in. The oice, he says, came down to this: What would you rather be doing? Devel- ing the next NMR technique or finding w drugs to treat cancer?"

For Norbeck, Fesik's lack of experience as actually a major selling point. "Inno- tion is often brought about by people utside of a field," Norbeck says. "Their norance about the established dogma lows them to do things that others al- ady had ruled out." Fesik's character so made him a good fit for the job. A lin- r thinker who loves puzzles and reading ientific papers, Fesik is doggedly ambi- tious and almost singularly focused on solving his next problem. Early on in his ca- reer, his wife had to negotiate with him a cutback in his work hours so he would be home at least one weekend day with their three young daughters.



That reactivates the death switch, causing cancer cells to weaken or die without harming normal cells

Unlike many scientists, Fesik isn't afraid to own up to his intellectual shortcomings. When the Internet was just taking hold, co-workers spotted him unabashedly reading *The Internet for Dummies* at his desk. Fesik tackled his new post with similar gusto for learning. He enrolled in a weeklong, brain-bruising course in clinical oncology for doctors prepping for their board certification exams. "Some heads of cancer research might find it embarrassing to admit they need to take a course like that," says James Summers, divisional vice-president for advanced technology. "Not Steve. He's unafraid."

HANDY TOOL

FESIK HAS BEEN on this path since his boyhood. He grew up in Lincoln, R.I., one of four children of a machinery-parts salesman and a part-time bookkeeper. To instill some worldliness in the brood, his mother spoke French at the dinner table. Fesik discovered early on that his brain was more suited to science. "I'm horrendous at languages," he says. "Science is logical; it makes sense." After earning a degree in chemistry from the College of the Holy Cross in nearby Worcester, Mass., he spent a year teaching high-school science in Maine.

The young scientist found his calling in NMR while in graduate school in Storrs, Conn. NMR is akin to magnetic resonance imaging in miniature. It turned out to be a handy tool for drugmakers because it allowed researchers to better comprehend the structure of the hundreds of thousands of chemicals in their libraries as well as the target sites in human cells that these medicines must fit into, like a key in a lock, to be effective. "He really has changed the way researchers use NMR in drug discovery," says Ad Bax, section chief of biophysical NMR at the government's National Institutes of Health, who considers Fesik a friendly rival.

Now, Fesik must prove that his research tool can result in a marketable product. Fesik first concocted ABT-737 in 1999. But there was a problem: The molecule also stuck to albumen, which is prevalent throughout the body. So the drug was doomed to get sopped up by healthy cells before it could ever reach the cancer. It took Fesik's team two more years to snap together molecular bits, like little Lego blocks, and come up with an alternative that attached only to the target protein and would be neither toxic nor too weak to cause the desired effect.

Fesik already has thought about the third chapter in his career, fantasizing about running a cancer institute or becoming a professor. But first he'll have to show that his drug works on humans. "The ultimate goal, if you get it, is fantastic," he says. "It's interesting scientifically, but more importantly, it could help a lot of people, let alone make a lot of money for Abbott." ■

Platts Top 250 Global Energy Company Rankings

Theo Mullen and Melissa Leonard

ASSET- AND REVENUE-RICH INTEGRATED OIL AND GAS companies (IOGs) dominate the top rungs of the 2005 Platts Top 250 Global Energy Company Rankings. There are only 31 IOGs in the 250-company ranking, but this segment monopolizes the top 12 spots. A quick financial profile tells the tale: IOGs claim average individual company assets of just over $53 billion, average annual revenues of nearly $62.3 billion, and profits of $5.3 billion. Total combined IOG annual revenue was just over $1.9 trillion. Our top-rated company, ExxonMobil Corp., reported assets of $193 billion, revenues of $264 billion, and profits of $25.3 billion.

No other energy industry segment can match those numbers.

For example, diversified utilities (DUs)—we cover 36—posted an average asset total of $20.1 billion—strikingly similar to electric utilities' (EU) $20 billion average company assets. DUs' annual revenues averaged just over $9.7 billion and profits hit $687 million—again very close to the financial performance of our 63 EUs. Total combined DU annual revenue was $351 billion.

In contrast with DUs, average assets of the 26 refining and marketing (R&M) companies on our list total a shade under $9.5 billion. But R&M average revenues are strong, just over $17.4 billion (the second-highest average). Average profits were $569 million. Total combined R&M annual revenue was just over $453 billion.

Top 10 Global Energy Companies

Platts rank 2005	Company name	State or country	Assets $ million	Assets Rank	Revenues $ million	Revenues Rank	Profits $ million	Profits Rank	Earnings per share $	Earnings per share Rank	Return on invested capital ROIC %	Return on invested capital Rank	Industry GICS code
1	ExxonMobil Corp.	Texas	195,256	1	263,989	3	25,330	1	3.89	57	22.9	10	IOG
2	Total SA	France	113,937	6	166,111	4	13,013	5	10.57	11	23.0	9	IOG
3	Chevron Corp.	California	93,208	10	142,897	5	13,034	4	6.14	23	23.3	8	IOG
4	BP plc	UK	191,108	3	285,059	1	15,731	3	4.23	43	17.3	34	IOG
5	Royal Dutch/Shell plc	Netherlands	192,811	2	265,190	2	16,623	2	4.30	40	16.9	38	IOG
6	ENI SpA	Italy	93,564	9	80,795	8	9,848	7	13.05	9	18.1	30	IOG
7	Petrochina Co. Ltd.	China	73,694	15	46,956	18	12,436	6	7.07	19	21.8	16	IOG
8	Shell Tran&Trade	UK	77,124	14	106,076	7	6,649	9	4.21	45	16.9	39	IOG
9	Statoil ASA	Norway	40,833	29	49,965	15	4,098	13	1.89	112	21.1	19	IOG
10	ConocoPhillips	Texas	92,861	11	118,719	6	8,107	8	5.79	24	13.9	59	IOG

Source: Platts

CITGO Petroleum Corporation

CITGO Petroleum Corporation refines, markets, and transports gasoline, diesel fuel, jet fuel, lubricants, refined waxes, petrochemicals, asphalt and other petroleum-based industrial products. CITGO has 4,000 employees and is owned by PDV America, Inc., an indirect, wholly owned subsidiary of Petróleos de Venezuela, S.A., the national oil company of the Bolivarian Republic of Venezuela.

CITGO owns and operates crude oil refineries in Louisiana, Illinois, and Texas and specialized asphalt refineries in New Jersey and Georgia. It also has a 41% interest in LYONDELL-CITGO Refining LP's refinery in Houston. CITGO's aggregate crude oil refining capacity of 970,000 bpd positions it as one of the largest refiners in the nation. The company owns or operates 54 petroleum product terminals.

In 2004, CITGO sold a total of 26.8 billion gallons of petroleum products and was the top gasoline marketer east of the Rocky Mountains and in the top five in the United States. The company markets motor fuels to independent marketer customers who previously rated CITGO the top supplier in the nation for eight consecutive years. CITGO's branded marketers sell motor fuels through more than 13,000 branded retail outlets. Through its CARCO subsidiary, CITGO is the largest supplier of asphalt on the East Coast.

Here's a summary of the total combined annual revenue r the other sectors we surveyed: independent power pro- cers (20 companies): $104 billion; exploration and pro- ction (30): $145 billion; commodity storage and transfer 7): $85 billion; gas utilities (21): $74.7; coal and con- mable fuels (6): just over $11.5 billion.

The return on invested capital (ROIC) of nearly every seg- ent we ranked this year—not just integrated oil and gas mpanies—improved sharply over last year's ranking: diver-

mong diversified utilities, Xcel nergy ranked #7 in the Americas nd #13 in the world.

fied utilities posted a ROIC of 7.7%, up from 1.3%; explo- tion and production companies recorded a ROIC of 12.8%, from 8.3%; electric utilities—5.3%, up from 4.8%; gas ilities—8%, up from 7.5%; and refining and marketing— 2%, up from 7.1%.

The three segments new to this year's rankings—coal and nsumable fuel, storage and transfer, and independent power roducers—posted ROICs of 12.8%, 9.5%, and –132%, spectively.

But don't judge the future of the utility and power indus- ies by the present, because you could be wrong. Also note that our rankings are based on 2004 financial data. Crude oil and natural gas prices exploded in 2005, allowing most IOGs to post record quarterly earnings. Next year, when our rankings are based on 2005 data, the gap between IOGs and the rest of the industry could well widen.

With some regional variations, most U.S. utility industry leaders expect the next five years to bring moderate demand growth, no major new environmental regulations, little new restructuring, favorable rate case outcomes, and capital markets that like the stable returns available from companies embracing the "back-to-basics" model. ■

Refining and marketing

OVERALL

Rank 2005	Company name	State of country	Platts rank 2005
1	Valero Energy Corp.	Texas	17
2	Indian Oil Corp. Ltd.	India	21
3	Nippon Oil Corp.	Japan	31
4	SK Corp.	Korea	34
5	Formosa Petrochemical	Taiwan	42
6	Reliance Industries Ltd.	India	49
7	Sunoco Inc.	Pennsylvania	56
8	Citgo Petroleum Corp.	Texas	57
9	Tonen General Sekiyu Corp.	Japan	65
10	Nippon Mining Holdings Inc.	Japan	72

Source: Platts

ndustry segments analyzed

- Diversified utilities
- Exploration and production
- Electric utilities
- Gas utilities
- Integrated oil and gas companies
- Refining and marketing
- Independent power producers
- Coal and consumable fuel companies
- Storage and transfer companies

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Xcel Energy

Richard Kelly, President and CEO

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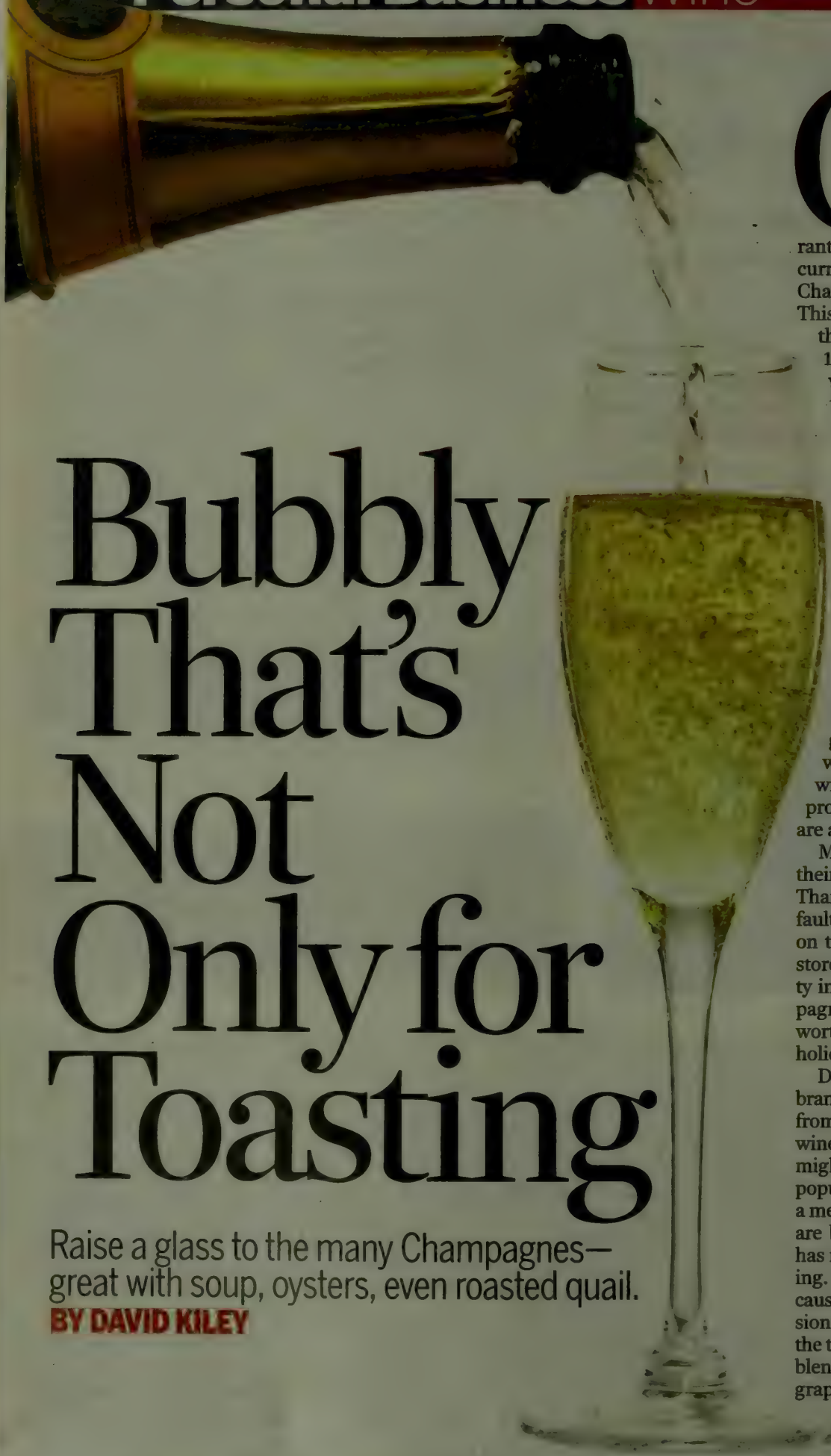
Xcel Energy is one of the largest U.S. combined electricity and natural gas utilities, serving 3.3 million electric customers and 1.8 million natural gas customers in 10 states from Minnesota to Colorado to Texas. At year-end 2004, Xcel Energy earned revenue of $8.3 billion and net income from continuing operations of $527 million, on $20.3 billion of assets.

Xcel Energy's strategy of building the core emphasizes the optimization of resources to achieve a reliable, cost-effective and environmentally sound energy mix. This strategy translates into reliable, reasonably priced and environmentally friendly energy for its customers. Through 2009, the company will invest nearly $7 billion in utility assets to meet the growing energy needs of its customers and to continue its environmental leadership. Currently, Xcel Energy exists as the country's second-largest provider of wind energy and intends to triple the use of this resource over the next several years.

Xcel Energy's emphasis on its traditional utility roots ensures that the company remains poised to provide its shareholders with a low-risk, competitive total return and its customers with the service they have come to expect.



Bubbly That's Not Only for Toasting

Raise a glass to the many Champagnes—great with soup, oysters, even roasted quail.

BY DAVID KILEY

CHAMPAGNE IS OFTEN r served for a special oc sion. But as I was havi lunch recently with D Perignon Chef de Ca Richard Geoffrey Michelin three-star resta rant Per Se in New York, the thought curred to me: I don't drink enou Champagne, especially with my fo This revelation came to me as we inhal the bubbles from the winery's 19 1976, 1990, and new 1998 vintag while enjoying master chef Thom Keller's white truffle risotto, amo his other sublime dishes.

Champagne, like BMWs and re ular spa treatments, has been exp riencing a surge in consumptio Over 300 million bottles left the c lar doors of Champagne houses 2004, according to their trade bo Comité Interprofessionnel du V de Champagne (CIVC). That's a ra surpassed only in 1999, at the pe of the dot-com bubble—or shou we say "bubbly." Sales are on tra this year to top last year's. An en brace of Champagne by nightclu goers (especially the hip-hop crow women drinking more sparkli wine, and a rising tide of restauran promoting sparkling wine with dinn are all driving sales.

Most people, however, still consum their annual take of bubbly betwe Thanksgiving and New Year's, often d faulting to a familiar name or whatever on the end-of-aisle display at the liqu store. But there has been so much activ ty in sparkling wines—especially Cham pagne—over the past few years that it worth exploring different possibilities f holiday toasts as well as meals.

Dom Perignon, with its extraordinar brand recognition, has naturally benefite from the growing interest in sparklin wines. Like Mercedes-Benz, the bran might raise the question of whether it popularity and wide acceptance cover u a mediocre product. Certainly some year are better than others, and the weathe has more to do with that than wine craft ing. But Dom has earned its status be cause of the winery's longstanding obses sion with balance and structure felt o the tongue—achieved through the carefu blending of chardonnay and pinot noi grapes—and a strong, long finish. Th just-released 1998 vintage ($11 to $130) doesn't disappoint. I

nds up perfectly as an aperitif. Creamy th bright citrus flavors, it was also an al accompaniment to chef Keller's oster. The smokier 1976 vintage ($776) nt well with pumpkin soup dotted with iny, tender Brussels sprout. The 1990 365), fatter and more buttery than the ers, was matched with oysters, caviar, d pearl tapioca.

Good Champagne is always worth asting. For that, flute or tulip glasses are ggested. But some winemakers and mmeliers suggest pouring in chardony glasses if you're drinking Champagne th food to get the full nose of the wine er the course of the meal.

The widest choices tend to be at ench and Asian restaurants, especially od sushi places. At The International r and Restaurant in London, 8 to 10 ampagnes are always on hand. Dom rignon's Geoffrey says he regularly es to Asia to meet with chefs. "[They] e influencing me more than anything se." During a recent lunch in Manhatn, chef de cave at G.H. Mumm & Co. ominique Demarville paired his new rease of Brut Champagne Grand Cru N.V., $56, with sea bass. Mumm's Carte Classique N.V. ($35), he says, "is a more logical accompaniment to many spicy Asian foods than a white still wine." At Unicorn, an Asian restaurant in Berkeley, Calif., I paired Henri Billiot Rosé Champagne ($65) with my lemongrass-roasted quail.

A TOAST FOR TWO

ROSÉ CHAMPAGNE, for a long time little more than a curiosity, has grown in popularity, especially with younger drinkers, and Champagne houses have been upping production and offerings. Generally rosé Champagne is made by adding a bit of red pinot noir or pinot meunier juice to the white base wine. Occasionally it's made by allowing brief contact with red wine skins while the grapes ferment. Some theorize that rosé is an aphrodisiac, making it ideal for a toast for two, but the only thing certain, based on sales, is that it appeals to women more than men.

Rosé Champagne is serious business, and good bottles are getting easier to find. Consider that Dom Perignon's 1990 Rosé sells for about $950, more than twice the price of its white Champagne of the same vintage. Veuve Clicquot Brut Rosé Champagne Grand Dame 1995 ($230) is excellent, with notes of raspberries and black pepper. Laurent-Perrier Brut Rosé Champagne Grand Siècle Alexandra 1997 ($95) is sweeter, with big mineral and strawberry tastes and a long finish.

The rush to bubbles is helping producers outside central France. California, Australian, and Italian makers are getting more aggressive in their marketing and better in their craftsmanship. Taittinger's Domaine Carneros Le Rêve Carneros 1999 ($59) and Schramsberg Brut Blanc de Blanc 2001 ($24 to $33) are among the California sparklers turning heads. Italians such as Bellavista Gran Cuvee ($49) stand up well to the French. The Australians sell mostly below $30, but many such as Seaview Brut N.V. ($10 to $17) are better than its price tag would indicate.

With competition and quality from other regions on the rise, it's no wonder that Dom Perignon's Geoffrey says: "I've always felt that the best work comes from great pressure." That's about what you would expect a Champagne maker to say. ■

Bright Bubbles

The six weeks between Thanksgiving and New Year's account for about half of Champagne sales. With new releases proliferating to capitalize on growing interest in French bubbly, here are some recommendations. Prices are averaged based on a survey of wine retailers and Internet merchants.

UPPER END

» **DOM PERIGNON 1998** $115 to $130.
The new release doesn't disappoint. Signature balance, young and citrusy.

SALON BRUT BLANC DE BLANCS LE MESNIL 1995 $240.
Lots of complexity. Bright acidity, with notes of peaches and honeysuckle. Big flavor.

TAITTINGER BRUT BLANC DE BLANCS 1995 $140.
Buttery and biscuity.

IN THE MIDDLE

» **GOSSET BRUT GRAND MILLESIME 1999** $65.
This new release has a lot of acidity showing through, with nice melon and toast. Good to cellar

MUMM BRUT CHAMPAGNE GRAND CRU NV $56.
This new sparkler has good balanced bread notes, bright acidity, and a bit of mandarin orange.

TAITTINGER CHAMPAGNE BRUT PRELUDE NV $70.
Strong finish, with bright peach flavors.

BIG VALUE UNDER $50

DUVAL-LEROY BRUT BLANC DE CHARDONNAY 1998 $45.
Bright mineral and honeysuckle, and slightly nutty.

» **JACQUART BLANC DE BLANC 1998** $32.
Another top choice if you need a case and not a bottle. Terrific toastiness, peach, and citrus notes. Well-balanced and long finish.

PERRIER JOUET GRAND BRUT, N.V. $35.
One of the steadiest nonvintage Champagnes under $50. Excellent choice if you need a case.

IN THE PINK

LAURENT-PERRIER BRUT ROSE CHAMPAGNE GRAND SIECLE ALEXANDRA 1997 $95.
Big mineral tastes along with strawberries and citrus. Long finish.

» **PHILIPPONNAT RESERVE ROSE BRUT** $36.
Melons, strawberries. Big value for a big wine.

VEUVE CLICQUOT BRUT ROSE CHAMPAGNE LA GRANDE DAME 1995 $230.
Like berries with pepper, and bread dough.

Away From It All On the Slopes

More intermediate skiers—and even preteens—are taking to untracked terrain. **BY SUSAN B. GARLAND**

STAY LOW Idaho's Sun Valley Heli-Ski

THAT WHIRLYBIRD YOU hear over snow-covered mountains may be the sound of a load of skiers being ferried to untracked terrain. If you'd rather be up there with them instead of taking another icy chairlift to the top of a crowded slope, think about booking a helicopter-skiing vacation. Or, if you're afraid of choppers, stay on terra firma and hitch a ride on a snowcat—essentially a heated cabin on wide bulldozer treads that can wend its way up steep paths.

Not so long ago this type of skiing was an indulgence reserved for expert skiers and snowboarders who had the skills to maneuver in the deep powder of the back country. But ski equipment technology has put it within reach of more people. "Powder skis are wider and allow more flotation. They have opened the doors to many intermediate skiers," says Joe Royer, who owns Ruby Mountain Helicopter Skiing in Lamoille, Nev. (helicopterskiing.com).

If you're more at ease on blue-square trails than black diamonds, make sure the company can accommodate you. Steamboat Powder Cats (blueskywest.com) in Steamboat Springs, Colo., which operates three snowcats a day, divides skiers into groups by skill level, sending out 12 with two guides and a driver. Manager Kent Vertrees says intermediate skiers stay on tracks with open glades and low angles. "There's nothing over their heads," he says. Expert skiers will be taken through trees and on slopes as steep as 40 degrees.

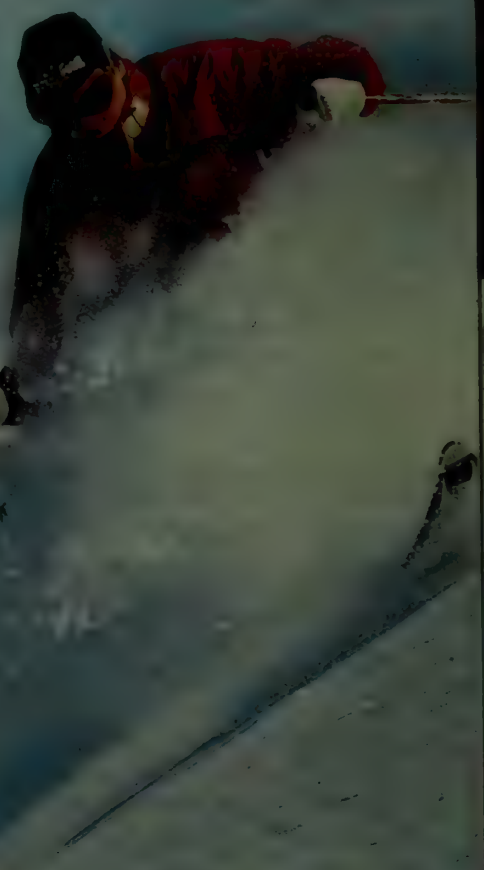
For back-country skiing, kids usually need to be at least 12 years old. Kim Gutner and Russell Davis, a psychiatrist and lawyer from Del Mar, Calif., have gone to British Columbia for a week of heli-skiing every year since 1997. This month they plan to take their daughters, ages 15 and 12, for the first time on a trip organized by Canadian Mountain Holidays, a multisite resort company based in Banff, Alberta, that's starting a family program. The cost of the Christmas-week trip is $5,155 for each adult and $2,578 per child, including meals, lodging, and non-ski, kid-related activities, according to canadamountainholidays.com. Mark Baumgardner, owner of Sun Valley Heli-Ski in Sun Valley, Idaho (sunvalleyheliski.com), says he has had guests as young as 10. "If the kids are mature enough to take direction and are good skiers, the trip can be a great bonding experience for the family," he says.

On a typical day heli-skiers can rack up 12,000 to 14,000 vertical feet in 6 to 12 runs. A chopper flies skiers to the top of lands, and lets them off. Then it flies off to pick up another group. When the first group gets to the bottom, the helicopter retrieves them and takes them to a new location. For snowcat skiing, the vehicle stays with the group.

REFUND POLICIES

THERE ARE DIFFERENCES between heli-skiing and snowcat skiing. A helicopter can fly to terrain snowcats cannot reach. Because choppers are faster, heli-skiers can cover more vertical feet. You pay extra for that: A day of heli-skiing costs as much as $750 to $850 per person, while a snowcat day goes for $225 to $350. Heli-skiers also run the risk of wind, heavy snow, or thick cloud cover canceling the expedition at the last minute, so check the operator's policy before you sign on. When its helicopters are grounded, Ruby Mountain uses snowcats, providing rebates if the guaranteed vertical feet are not met. Sun Valley offers a rain check or the chance to ski the next day, or charges $100 if you want a refund.

No matter what your skill level, back-country skiing carries risks. Although helicopters occasionally crash, a more common safety issue is avalanches. Last year



LOOK MA, NO CROWDS Heli-skiers can do 6 to 12 runs a day

PHOTOGRAPHS BY HILLARY MAYBERRY

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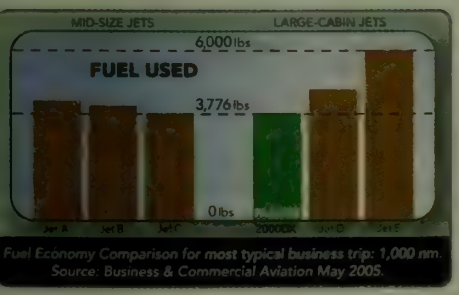

Fuel Economy Comparison for most typical business trip: 1,000 nm. Source: Business & Commercial Aviation May 2005.

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37 skiers, snowmobilers, and hikers in the U.S. and Canada died in avalanches, according to the American Avalanche Assn. Prospective skiers should ask about the guides' training in avalanche rescue as well as precautions the operator takes to check for potential hazards and the procedures in case of a slide.

At Sun Valley and Ruby Mountain, each skier wears a transceiver that emits an electronic signal alerting the others if the skier is caught in a slide. The guide leading a group of four will start off first and then shelter behind an "island of safety," a rock or ridge that affords protection in case of an avalanche. The others follow one by one, always in view of one another.

Even the best plans can go awry. Ken Ambrose, 57, a heli-skier who owns a company in San Francisco that manages corporate flight departments, once found himself "tumbling down in a cascading wave of snow" that covered him to his shoulders. The rest of the group, which had been standing behind a rocky outcrop, rescued him within seconds. "It really gives you a respect for snow safety," he says. "If you have people in safe islands, they can dig you out."

SNOWCAT It carries skiers to powder for up to $350 a day

To find heli-skiing in the U.S., check the Heli Ski U.S. Assn. at

heliski.org. For snowcat operators, use a search engine or a travel agency that specializes in skiing. Snowcat companies are often located near ski resorts. For Canada, check the British Columbia Helicopter & Snowcat Skiing Operators Assn. (bchssoa.com). Depending on the operator and its location, you can purchase a day at a busy mountain resort or a three- to seven-day package, including lodging and meals, in an isolated area. The chance to ski down untracked runs from remote mountain tops is well worth the cost. And for powder heads, there's no better way to go. ■

Safari in the Snow

On one trip, you could head downhill at Jackson Hole, Steamboat Springs, then Vail. BY SUSAN B. GARLAND

IF YOUR SKIING FRIENDS SUGgest going on a safari this winter, they're probably not offering you a chance to spot leopards and elephants from the back of a Land Rover. They're talking about a ski safari, an increasingly popular way to sample the runs at two or more resorts in one trip.

Like its African counterpart, a ski safari is designed to provide travel, adventure, and diversity. You may even see some wildlife, in this case the stray deer, elk, or bear that crosses your path. "Skiers like fresh experiences," says David Tanner, president of Rocky Mountain Vacations, a ski tour operator in Glenwood Springs, Colo. "Each major mountain has a unique personality."

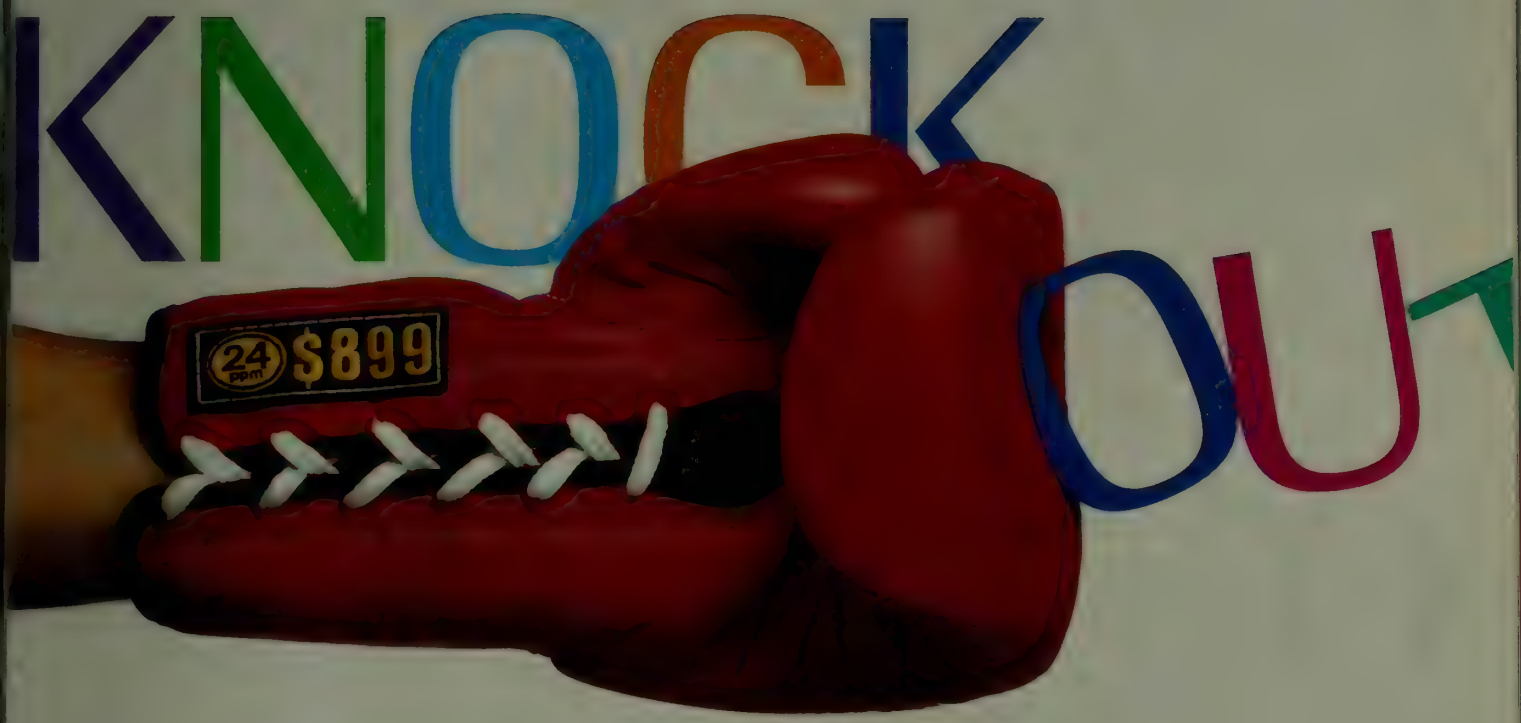
The ski safari has long been a tradition in Europe, where many resorts are interconnected and skiers can schuss from village to village across a mountain range that spans borders. In the U.S., ski tour operators have adapted the concept for resorts that are spaced farther apart.

Rocky Mountain Vacations created an itinerary for Justin Curran, now a 25-year-old medical student at Michigan State University, that took him and some friends to 13 resorts in Colorado, Utah, and Wyoming. Curran's 2003 month-long safari was longer than most, but the goals were the same: to sample a variety of ski conditions, nightlife, and scenery.

Curran learned that Jackson Hole, Wyo., has the "steepest, craziest line 2,500 acres of backcountry, and th coolest town in the West. The bars hav as many cowboys as skiers." In Steam boat Springs, Colo., he enjoyed skiin through aspen groves and the feather "champagne snow." At Vail, he tackle the back bowls, and outside Salt Lak City he tried the "steep, gnarly slopes o Big and Little Cottonwood Canyon."

Like Curran's, most safaris in the U.S are customized itineraries. "These skier have been skiing a long time and wan something different," says Craig Cook owner of Travel Organizers/American Express in Englewood, Colo. He say many safari seekers prefer less well known resorts. One of his favorite trip covers Snowbasin and Powder Mountai resorts, 45 minutes from Salt Lake City He books skiers into lodging in Ogden Utah, a rustic town nearby. The packag runs $600 to $1,000 per person.

Some areas are pushing their own ver sion of the ski safari. Although the re sorts aren't interconnected, they're clos enough that you can settle into one hote and take day trips. Vail Resorts sells th "Perfect 10" lift pass at $419 for adult and $299 for kids under 12. It's good fo 10 days at Beaver Creek, Breckenridge Keystone, and Vail, Colo.; and Heavenl Mountain in Lake Tahoe, Calif. So if yo can't decide between the back bowls o the groomed trails, the sleepy town, o the lively village, you can have it all. ■



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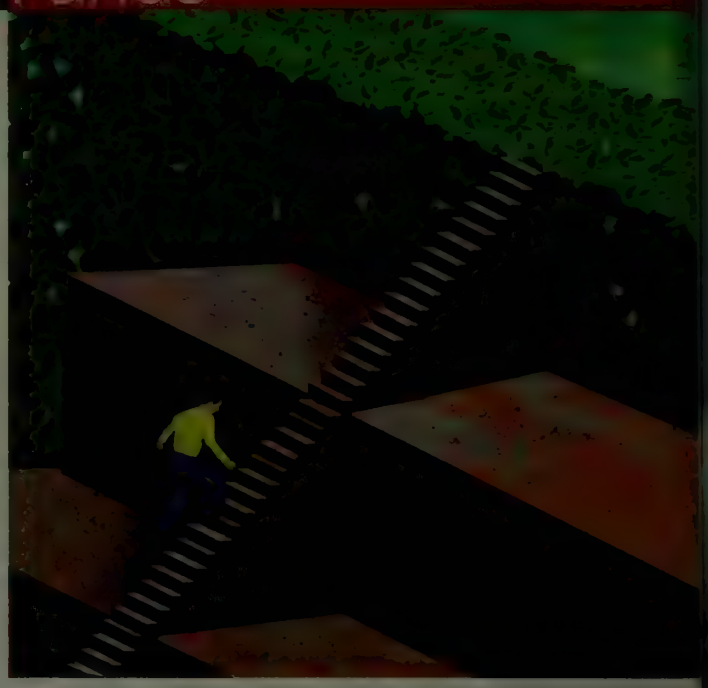

Funds Made To Deliver

"Absolute return" mutual funds aim for a positive result no matter how the stock market does. **BY LEWIS BRAHAM**

ONE OF THE DRAWbacks of investing in mutual funds is that you can have relatively good returns but absolutely awful results. That's because most funds measure success—and the manager's bonus—on whether they beat a benchmark like the Standard & Poor's 500-stock index or a composite of competitor funds, not whether its shareholders actually make any money. In 2002, when the S&P 500 lost 22% of its value, a fund losing just 10% would have been a winner.

Now a new breed of mutual fund is emerging known as the "absolute return" fund. Using techniques more akin to hedge funds, these funds try to make a positive return no matter what's happening in the stock market. Such funds as Alpha Hedged Strategies Fund and Rydex Absolute Return Strategies Fund invest in areas where most mutual funds don't—among them currencies, commodities, distressed debt, convertible-bond arbitrage, and merger arbitrage.

There are too few absolute-return funds with track records long enough to say whether these investments succeed. The oldest of them, Alpha Hedged Strategies, opened in October, 2002, has a 7% average annual return over the last three years. Manager Lee Schultheis uses hedge fund consultant Trust Advisors to vet the managers, and he determines how much money to allocate, based on their investment styles. Although investors are not paying hedge fund-like fees—1% to 2% of assets a year plus 20% of the profits—this mutual fund is costly. The expense ratio is 3.99% vs. an average 1.48% for equity funds. The second oldest fund, Agile Multi Strategy, has an even higher expense burden, 4.12%—and a losing record, down 5% since its January, 2004, launch.

Using hedge fund strategies for better returns

DIVERSE APPROACHES

RYDEX ABSOLUTE Return Strategies, barely two months old, takes a very different approach. Manager Jeff Joseph turns to computer-driven models to study some 3,000 hedge funds which fall into 13 broad categories. He then designs his portfolio to mimic the kinds of funds that are performing best and rebalances his portfolio monthly. No one strategy ca exceed 55% of his portfolio.

The downside of Rydex Investment approach is that the firm has little exper ence implementing it. Joseph says tha doesn't matter; numerous studies indi cate that the lion's share of hedge fund re turns are derived not from manageria skill but from employing identifiable an imitable strategies. The Rydex approac is certainly more economical: The ex pense ratio is just 1.40%.

Somewhere between these two ap proaches is the UBS Dynamic Alph Fund—a $1.7 billion fund. The fund has 1.32% expense ratio, and it also has deep and experienced management tear led by Brian Singer and access to mor than 100 stock and 20 bond analysts a UBS Global Asset Management. The fun doesn't use all the strategies open to th other two, but it has the ability to buy o sell short almost any stock, bond, or cur rency throughout the world. That ma present some intriguing opportunities i the bond sector, where the fund currentl has a short position in Japanese bonds Given that Japanese interest rates ar close to zero, any rise in rates from an im proving economy will cause bonds to fa and net gains for this fund.

Another middle-of-the-road fund i Absolute Return Strategies. Like Alph Hedged Strategies, this fund parcels ou money to other advisers. But not all goe to hedge fund managers. About a third o the fund's portfolio is invested with mu tual fund companies such as Loomis Sayles & Co. and Yacktman Asset Man agement that rarely, if ever, hedge.

Given how new these funds are, it ma be best to watch and wait to see if the can absolutely deliver. ■

In Search of Absolute Profits

FUND/SYMBOL	EXPENSE RATIO	SALES CHARGE	ASSETS (MILLIONS)
Absolute Strategies A ASFAX	2.25%	4.50%	$80
Agile Multi-Strategy AMSRX	4.12	None	28
Alpha Hedged Strategies ALPHX	3.99	None	147
Rydex Absolute Return Strategies H RYMSX	1.40	None	8
UBS Dynamic Alpha A BNAAX	1.32	5.50	1,700

Data: Morningstar and fund companies

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WINTERS Buffett is a hero—but so is Robert Frost

Against the Grain Investing

David Winters, a student of maverick Michael Price, opens his own mutual fund. BY ADRIENNE CARTER

DAVID J. WINTERS could have started a hedge fund, with its fatter fees and light regulation. But after the 43-year-old left his job as chief investment officer of Franklin Mutual Advisers funds in May, he started a mutual fund shop, Wintergreen Advisers. The firm's first retail offering, Wintergreen Fund, opened on Oct. 14 and has thus far gained 1.2%. The firm would not disclose the fund's size.

A 20-year veteran of the industry, Winters felt comfortable sticking with mutual funds. And individual investors are the ones who most need innovative investments, he says. In any case, mutual funds can use many of the same strategies as hedge funds (page 116); it's just that many managers would rather ply those skills in a format where they can charge higher fees and take a cut of the profits.

The suspenders-wearing, bespectacled Winters, who quotes Robert Frost as eloquently as he does Warren E. Buffett, has always gone against the grain. At Mutual Series, where he honed his skills under famed value investor Michael Price, he built an impressive record buying stocks and bonds that other investors wouldn't touch. A $10,000 investment in Mutual Discovery—which invests abroad as well as in the U.S.—when Winters took over in February, 2000, would have been worth $16,111 when he stepped down, v $9,658 for the typical world stock fund.

In many ways, Wintergreen is mo like a hedge fund than a mutual fun Many mutual fund managers are clos indexers or stick to a narrow piece of th market. But Winters, who has be known to read annual reports while r laxing in a canoe, can invest in just abo anything. He can also short stocks a participate in private equity deals. "If yo love investing, you want to have a pala with as many colors as possible," he say

In fact, the only common characteris of his purchases is likely to be their ba gain-basement prices. Winters seeks o the most unloved are of the market, findin value even in ban ruptcies. Sitting in h sparse Mountain Lake (N.J.) office, he tall gleefully about the potential fro blowups like the recent ones in autom biles and airlines. Although he won't s what he's buying, Winters says he avoiding telecoms: "The traditional tel phone business is under siege, and mo companies don't acknowledge it."

A ONE-MAN SHOW

LIKE PRICE, WINTERS also hopes to b an activist investor. In 2001 he urge Meredith Corp. to diversify the boar boost margins, and split up the magazin and broadcasting groups. It started to r ally listen when he bought 5% of th shares. Although the firm didn't take all o his advice, it changed its ways—pushin the stock from $30 to $50.

Wintergreen's strategy is research-in tensive, yet so far it's a one-man show Winters says he may hire several re searchers over the next year. Annual ex penses are 1.95% of assets—high for typical equity mutual fund but not fo hedge fund-like mutual funds. There's n sales charge, either.

Winters' love of trains firs brought him to Mutual Series. Afte graduating from Cornell University he traveled the Canadian railroad and later discovered the little-trade Richmond, Fredericksburg & Po tomac Railroad. To buy five shares he called one of the stock's marke makers, Hans Jacobson, who late offered him a job. Jacobson, it hap pened, worked in the same room a Price. "Price hired ambitious kid and preferred to train you to think," say Winters. "His mantra was, 'D the work.'" It's a key lesson as h ventures out on his own. ■

A Free-Range Fund

David Winters' mutual fund operates more like a hedge fund. He:

- Places **no limits** on the investing styles he uses, and can also short stocks.
- Looks for **bargain-basement** buys, emulating his mentor, Michael Price.
- Won't hide his **activist** bent in pushing for change at underperforming companies.
- Seeks out **troubled companies,** even finding opportunities in bankruptcies.

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EDITED BY TODDI GUTNER

ENTERTAINING

SPICE IT UP WITH HOLIDAY BREWS

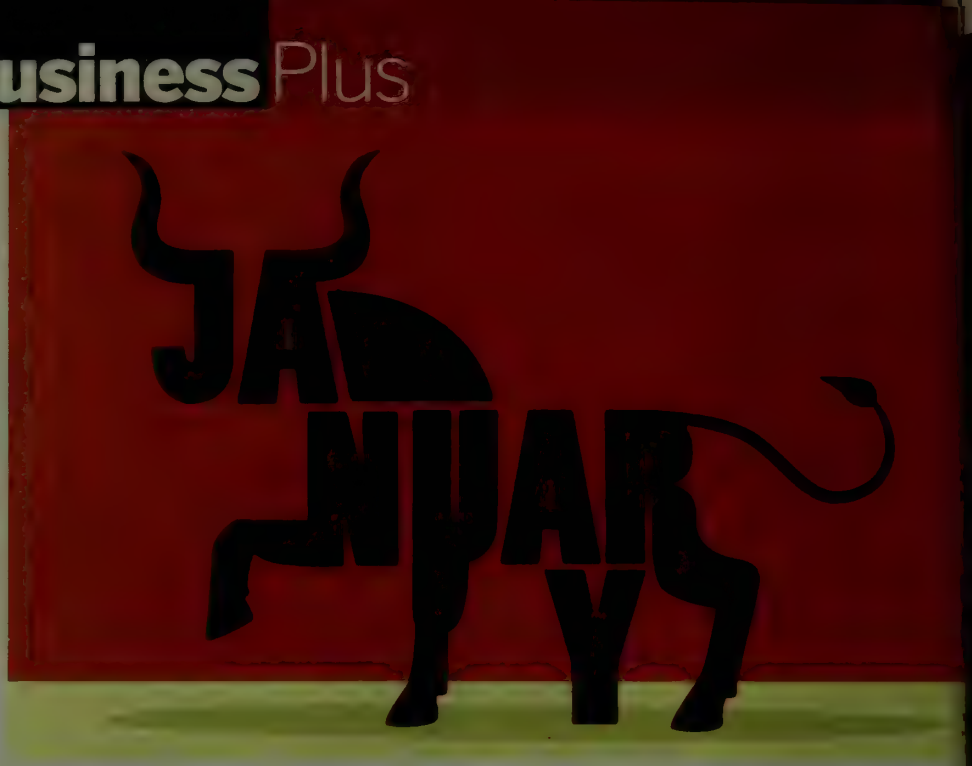
YULETIDE PARTY HOSTS just love to serve creamy, nutmeggy egg nog and Champagne or other sparkling wines (page 106). What about beer? The major brewers offer seasonal beers that can add spice to your table. To help choose among them, we assembled a group of experienced Chicago drinkers—not hard to find—for a blind taste test.

Pumpkin brews make a nice complement to many seasonal dishes. The cinnamon aroma of **Michelob Pumpkin Spice Ale** evokes winter festivities. You can also buy the brew in a sampler pack with **Michelob Marzen** and **Pale Ale,** good alternatives for revelers who find the spicy, flavored beers to be "overpowering." **Blue Moon Pumpkin Ale,** which smelled of canned pumpkin, got a thumbs-down from the group.

The **Samuel Adams Winter Classics Pack**—with six varieties of beer—featured a number of crowd pleasers. **Sam's Holiday Porter** had a pleasing toffee flavor that one tester said was "like Guinness, but better." It had a similar aroma to the Irish stout but wasn't nearly as heavy. My favorite was **Sam's Cranberry Lambic,** even though hard-core beer drinkers turned up their noses at the touch of sweetness that gave it an almost fruity flavor.

By far the biggest winner was **Celebrate** by **Michelob,** a brew that's aged in bourbon-barrel oak. One tester called it "a dessert and beer in one." Another said it "smells like frosting" with vanilla and caramel flavors. Indeed, an Anheuser-Busch brewmaster says it goes well with chocolate desserts. Now, if only there were a beer that made fruitcake taste better.

–Adrienne Carter



INVESTING

A New Year's Bet

REPORTS OF THE DEMISE of the "January effect" may have been greatly exaggerated. Academic researchers discovered 30 years ago that stocks typically go up in January. Subsequent research was less definitive, and concerns grew that so many investors were trying to profit from the anomaly that it might no longer hold true. So **University of Kansas Business School** professors Mark Haug and Mark Hirschey crunched data (going back to 1802 for large-cap stocks) to determine whether the effect is real or imagined. In a paper to be published in an upcoming issue of the *Financial Analysts Journal*, they found large caps showed a somewhat elevated performance in January—about a half a percentage point better than in other months.

But small-cap stocks logged an average monthly gain of 6.1% in January (since 1927 when the data begin)—far better than the 0.9% average for the other 11 months. And they have gone up in January 82% of the time, says Hirschey. A way to make the January play is to buy **iShares S&P Smallcap 600 Index** and **Vanguard Small Cap VIPERS,** both exchange-traded funds.

–Aaron Pressman

TIME OFF

WHO'S HAVING A BIG 2006 birthday besides baby boomers turning 60? Ben Franklin: It's his 300th. In honor of the statesman, founding father, and inventor (bifocals, swim flippers), "Benjamin Franklin: In Search of a Better World" opens at Philadelphia's National Constitution Center on Dec. 15. The exhibit features original copies of the Declaration of Independence and the U.S. Constitution signed by Franklin as well as over 250 artifacts (benfranklin300.org). The show will travel to St. Louis, Houston, Denver, and Atlanta before ending in Paris in 2008.

–Lauren Young

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FLIGHT OPTIONS

On a Higher Plane

BY GENE G. MARCIAL

A DEAL WITH NEWS CORP. MAY LIE AHEAD FOR LIBERTY MEDIA.

SPECTRANETICS LASERS ARE IN DEMAND FOR BLOCKED ARTERIES

A MAJOR PLAYER IN CHINA'S BUSTLING INTERNET IS SOHU.COM.

Liberating Liberty's Value

LIBERTY MEDIA (L), controlled by cable mogul John Malone, is attracting an eager crowd of value players. They see Malone's plan—to unlock the value of Liberty's assets by splitting them up—as a big winner that could lead to a deal with News Corp. Liberty will create a tracking stock called Liberty Interactive, to include its wholly owned shopping network QVC, Liberty's 20% stake in IAC/InterActiveCorp, and Expedia. Malone hasn't said when the tracking stock will be launched. Popular in the late 1990s, tracking stocks can free assets that have been submerged in the parent company to appreciate separately. So the split will add to Liberty Media's overall value, figures Steve Rogé of Rogé Partners Fund. Investors who own Liberty stock, now trading at 7.68 a share, will get a proportionate share of the tracking stock. The rest of Liberty's holdings, including its 100%-owned movie channels Starz and Encore, its 17% in News Corp., plus 4% in Time Warner, will be lumped together in an entity called Liberty Capital. Rogé believes dividing Liberty Media is a prelude to striking a deal with Rupert Murdoch, who controls News Corp., on Liberty's stake in News. When asked during a recent conference call if he and Murdoch were in talks, Malone replied: "We're talking all the time." Any deal will be a big plus for Liberty, Rogé says. Malone could either sell Liberty Capital to News or merge with it, he says. He puts Liberty's breakup value at 14 a share. "A major deal with News is inevitable," says Ted Henderson of securities firm Stifel, Nicolaus. Michael Kupinski of A.G. Edwards rates Liberty a buy, noting it trades below its net asset value of $12.85 a share. A NewsCorp. spokesman didn't return a call for comment

READY FOR A REMEDY

Data: Bloomberg Financial Markets

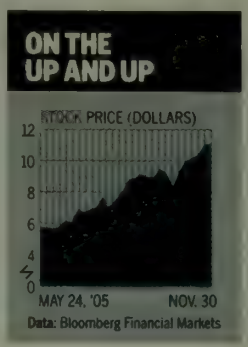
30 Blue Chips in one

Diamonds (DIA) are all 30 gems of the Dow Jones Industrial Average wrapped up in one neat exchange trade and of course, they are subject to similar risks. Ask your advisor for details. It's a smart way to add luster to your po

An investor should consider investment objectives, risks, charges and expenses of the investment company carefully before inv read the prospectus carefully before investing. *Usual brokerage commission applies. Dow Jones Industrial Average,℠ The Dow® and Dia with Dow Jones. Diamonds are not sponsored, endorsed, sold or promoted by Dow Jones and Dow Jones makes no representation regarding the adv ALPS Distributors, Inc., a registered broker-dealer, is distributor for the Diamonds Trust, a unit investment trust.

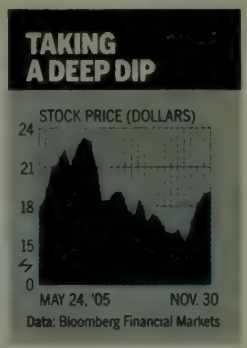
Why Spectranetics Is Special

TINY MEDICAL DEVICE maker Spectranetics (SPNC) has been a stock on the go, climbing since May from 5 to 11. Its devices are used to treat coronary artery ailments. s CVX-300(R) laser is the only Food & rug Administration-approved system r removing plaque and clots in blood ssels. In April, Spectranetics won FDA proval to use the laser for removing ockages in leg arteries. The mpany's laser is gaining "significant tention in the medical community," ys Suraj Kalia of investment firm odman & Renshaw, who tags the ock "outperform," with a target of 14. cclusions in arm and leg arteries will e a large market for Spectranetics, says latt Duncan of investment firm Stephens. He expects earnings jump from 3¢ a share on sales of $55 million in 2006 to 14¢ 2007 on $68 million. Elizabeth Jones of Kornitzer Capital lanagement, which owns stock, says the volume of laser rocedures are on the rise and puts Spectranetics in a "sweet pot" in a fast-growing market.



Sohu.com Spreads Its Web

WITH CHINA'S VAST Internet market in high gear, some pros are rushing to snap up shares of the big operating companies in the Chinese Web world. ne such is Sohu.com (SOHU), which trades on the NASDAQ. It is No. 2 in online ad revenues, offering content, brand advertising, search services, online game services, and e-commerce through its seven Web portals. "Sohu is a well-established brand that will benefit from the underlying growth of China's online advertising market," says Tian X. Hou, the Internet guru at investment firm C.E. Unterberg, Towbin. She sees the stock, now at 19, hitting 23 in a year. That's her conservative number. She figures the stock could hit 33 if the company achieves its expansion goals. Sohu, she says, is jumping on the new trend in online advertising. It's moving away from traditional portal sites and focusing instead on "vertical" sites that cater to specific markets or products that draw bigger ad dollars. She puts the value of its Web properties at $1 billion to $1.2 billion, compared with its market cap of $600 million. Hou figures Sohu will earn 75¢ a share in 2005 on sales of $107 million, 87¢ in 2006 on $134 million, and $1.07 on $188 million in 2007. She sees the online ad market in China more than quadrupling in the coming five years—from $294 million in 2005 to $1.3 billion in 2010. Among Sohu's big investors: Tudor Investment, which has a 4% stake, and Barclays Bank, with 2%. ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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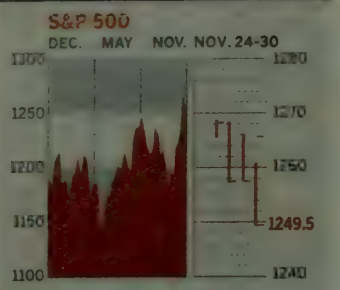
STOCKS



COMMENTARY

The indexes hit new highs on Nov. 25 before falling the next few days on light volume and worries that the Fed may tighten in the face of a resilient economy. Retailers, traditionally gloomy as the shopping season starts, have been cheered by the drop in gas prices and jump in consumer confidence. Look for an end-of-year stock rally, market watchers say.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	NOV. 30	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1249.5	-1.3	3.1	6.4
Dow Jones Industrials	10,805.9	-1.0	0.2	3.6
NASDAQ Composite	2232.8	-1.2	2.6	6.5
S&P MidCap 400	733.7	-1.0	10.6	15.1
S&P SmallCap 600	354.3	-0.8	7.8	10.0
DJ Wilshire 5000	12,496.6	-1.2	4.6	8.2
SECTORS				
BusinessWeek 50*	749.7	-1.5	6.4	9.3
BW Info Tech 100**	381.5	-0.6	2.2	6.1
S&P/BARRA Growth	598.3	-1.1	2.8	6.3
S&P/BARRA Value	646.8	-1.4	3.4	6.6
S&P Energy	371.0	-2.8	28.5	25.9
S&P Financials	425.9	-2.0	3.6	7.8
S&P REIT	154.8	-1.0	7.2	11.4
S&P Transportation	247.3	-0.7	2.4	5.4
S&P Utilities	150.4	-0.7	11.8	14.5
GSTI Internet	207.9	-1.3	16.6	27.3
PSE Technology	840.5	-0.6	7.9	11.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	NOV. 30	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1450.6	-0.8	[illegible]
London (FT-SE 100)	5423.2	-2.0	12.6
Paris (CAC 40)	4567.4	-0.9	19.5
Frankfurt (DAX)	5193.4	-0.1	22.0
Tokyo (NIKKEI 225)	14,872.2	1.1	29.4
Hong Kong (Hang Seng)	14,937.1	-0.8	5.0
Toronto (S&P/TSX Composite)	10,824.1	-0.9	17.1
Mexico City (IPC)	16,831.0	0.7	30.3

FUNDAMENTALS	NOV. 29	WEEK AGO	YEA[illegible]
S&P 500 Dividend Yield	1.81%	1.80%	1.9[illegible]
S&P 500 P/E Ratio (Trailing 12 mos.)	18.5	18.5	19
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.1	16
First Call Earnings Revision*	-1.99%	-2.27%	-0.[illegible]

*First Cal[illegible]

TECHNICAL INDICATORS	NOV. 29	WEEK AGO	RE[illegible]
S&P 500 200-day average	1204.3	1203.1	Pos[illegible]
Stocks above 200-day average	61.0%	61.0%	Neu[illegible]
Options: Put/call ratio	0.69	0.70	Neu[illegible]
Insiders: Vickers NYSE Sell/buy ratio	3.13	2.90	Nega[illegible]

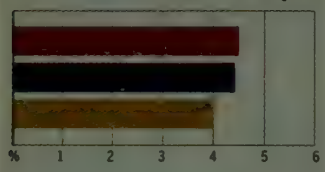
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
IT Consulting	20.4	Oil & Gas Refining	66.8
Paper Products	19.3	Fertilizers & Ag. Chems.	59.2
Steel	17.3	Managed Health Care	50.9
Home Furnishings	17.2	Oil & Gas Drilling	48.6
Constr. & Engineering	16.5	Homebuilding	44.6

WORST-PERFORMING GROUPS	LAST MONTH %		LA[illegible] MON[illegible]
Automobiles	-11.2	IT Consulting	-4
Oil & Gas Refining	-5.7	Automobiles	-4
Oil & Gas Storage	-3.6	Photographic Products	-2
Agricultural Products	-3.3	Auto Parts & Equip.	-2
Genl. Merchandise Chains	-3.3	Home Furnishings	-2

MUTUAL FUNDS

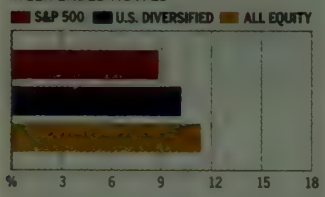
4-WEEK TOTAL RETURN

WEEK ENDED NOV. 29



52-WEEK TOTAL RETURN

WEEK ENDED NOV. 29



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	12.0	Latin America	64.0
Latin America	6.2	Natural Resources	33.2
Real Estate	6.0	Diversified Emerg. Mkts.	31.7
Technology	6.0	Japan	26.9
LAGGARDS		**LAGGARDS**	
International Hybrid	2.1	Domestic Hybrid	6.5
Europe	2.1	Miscellaneous	7.1
Utilities	2.3	Technology	8.6
Natural Resources	2.4	Large-cap Blend	8.7

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds. Semicdr. Inv.	19.6	ProFunds Ultra Japan Inv.	85.5
ProFunds Precs. Mtls. Inv.	16.3	T. Rowe Price Lat. Am.	70.2
Fidelity Select Gold	16.0	iShares S&P L. Am. 40 Idx.	68.0
ProFunds Ultra Japan Inv.	15.4	iShares MSCI Brazil Idx.	67.3
LAGGARDS		**LAGGARDS**	
Rydex Dyn. Vent. 100 H	-11.3	American Heritage Grth.	-42.9
ProFunds UltSh. OTC Inv.	-11.3	American Heritage	-27.3
Potomac Sm. Cap/Sh. Inv.	-9.1	ProFds. USh. Mid Cap Inv.	-25.1
ProFds. USh. Sm. Cap Inv.	-8.9	Frontier MicroCap	-20.8

INTEREST RATES

KEY RATES	NOV. 30	WEEK AGO	YEAR [illegible]
Money Market Funds	3.59%	3.56%	1.50
90-Day Treasury Bills	3.94	3.95	2.23
2-Year Treasury Notes	4.41	4.35	3.00
10-Year Treasury Notes	4.49	4.49	4.35
30-Year Treasury Bonds	4.68	4.70	5.00
30-Year Fixed Mortgage †	6.19	5.20	5.68

†BanxQuote, In[illegible]

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.91%	4.52%
Taxable Equivalent	5.59	6.46
Insured Revenue Bonds	3.99	4.57
Taxable Equivalent	5.70	6.53

THE WEEK AHEAD

NONMANUFACTURERS' INDEX *Monday, Dec. 5, 10 a.m. EST* » The Institute for Supply Management's November nonmanufacturing activity index is expected to have eased to 59%. That's the median forecast among economists polled by Action Economics LLC. The October index rebounded to 60%, an indication that most respondents suffered only temporary disruptions from Hurricanes Katrina and Rita, while the new orders and backlogged orders indexes showed that demand remained solid.

FACTORY INVENTORIES *Tuesday, Dec. 6, 10 a.m. EST* » Manufacturing inventories in October most likely rose 0.3%, reflecting the month's rebound in production. September inventories fell for a second straight month in part because of bottlenecks resulting from the hurricanes. With demand for factory goods holding strong, inventory levels should begin increasing once again.

INSTALLMENT CREDIT *Wednesday, Dec. 7, 3 p.m. EST* » Consumers probably took on $4.3 billion of additional debt during the month of October, following a small September decline caused by a slowdown in vehicle sales. Depending on holiday sales, this year's increase in consumer credit could be the smallest since 1993.

The *BusinessWeek* production index edged up to 262.4 for the week ended Nov. 19, a 13.2% increase from the previous year. Before calculation of the four-week moving average, the index moved up to 263.5.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

Music Lives

SUCCE

Kids who study music are more likely to be elected to class office[1] and are less likely to watch television.[2] The problem is, there aren't enough instruments to go around. That's why Paul McCartney and Fidelity support The Music Lives Foundation. Visit us today at musiclives.org and show your support with a commemorative bracelet. Because music students make better students.

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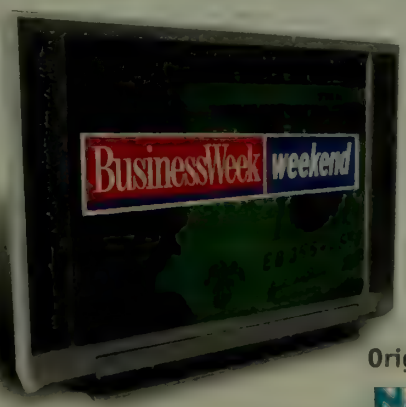

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How the Mighty Fall

COMPETITION DEMYSTIFIED A Radically Simplified Approach to Business Strategy
By Bruce Greenwald and Judd Kahn; Portfolio; 399pp; $26.95

Wal-Mart Stores Inc. has become a beacon for bargain-minded shoppers, even as its daunting market power and controversial management practices have made it a lightning rod for criticism. Investors, though, see a once innovative outfit whose stock has been flatlining for at least five years.

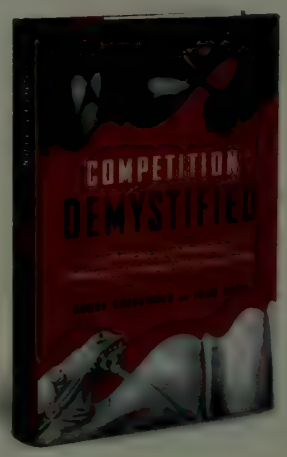
Profitability has slipped since the chain began a national expansion in the mid-1980s. More recent pushes abroad have produced disappointing returns. What could Wal-Mart have done to grow and avoid the disappointments? "Probably not much," argue Columbia Business School professor Bruce Greenwald and investment manager Judd Kahn. Given its competitive landscape, they say, the company's fate was to move "from great to good."

To fans of the still fabulously powerful retailer, that view may seem harsh. But Greenwald and Kahn, authors of *Competition Demystified*, have seen too many titans rise and inevitably fall to be all that bullish. In this take-no-prisoners look at corporate strategy, the pair dissect such ambitious but ill-fated stumblers as Coors and Coca-Cola Co. and warn about the future of such powerhouses as News Corp. They argue that entrenched big companies face daunting challenges to growth, adding that the urge to hammer rivals, instead of simply exploiting their own competitive edges, "has been a continual source of poor performance." They make a compelling case. But they underestimate the possibility that, given the right innovations, savvy managers can reinvent their companies.

The authors use case studies to lay out a theory of competition that, in the end, turns out to be familiar. That's because they are trying to "clarify" a handful of key competitive forces described 25 years ago by management guru Michael Porter in his classic *Competitive Strategy*. They aim to one-up the master by emphasizing some of his insights more than others and by making them simpler to grasp. Thus their promising subtitle, *A Radically Simplified Approach to Business Strategy*. Regrettably, their work is anything but elementary. It is burdened by incomprehensible diagrams, equations that will elude general readers, and occasionally dense prose: "Suppose that the error range on the EPV of the firm as a whole is plus or minus $150 million around the mean estimate of $1,500 million. This is plus or minus...."

Still, the case studies and the pair's sharp analyses in this uneven work are worth the cover price. They offer important lessons for managers and investors alike. Take Wal-Mart: Returns have slipped as the company has grown because it has been unable to replicate, outside of the original small and largely rural markets, its most potent advantages—local economies of scale and customer loyalty that keep competitors at bay. The authors argue persuasively that in retailing and a few other areas—banking, health care, and even telecom—dominating a small geographic region is key. That's why companies as disparate as BellSouth Corp., Kroger Co., and regional banks tend to outperform national players.

Growth outside one's backyard, they contend, can be deadly. As a niche player in the West, Colorado-based Adolph Coors Co. boasted double-digit margins that made national rival Anheuser-Busch Cos. look pale. But as Coors rolled out its brands nationally, profitability slumped, its once-envied mystique—that Rocky Mountain spring-water image—dissipated, and it wound up slipping into a transnational merger with Molson in mid-2004 that so far has done nothing for investors. Coors might have done much better if it had stuck to a dozen or so states, say the authors.



Are there smart ways to grow? Sure. Rupert Murdoch's News Corp. built a fourth TV network, Fox, by exploiting weaknesses in the other three: undercutting them in advertising prices while airing audience-pleasing programming that rivals disdained as downmarket. Still, lately News Corp. has disappointed investors for different reasons, including vulnerability to cable and other alternatives that are hurting all the networks. "The networks are still with us, Fox included, but they are not the cash-generating machines they used to be," the authors say.

Many giants get hurt trying to grow outside their backyard, the authors say

It must be stated that the authors' pessimism about mature companies isn't always justified. Many have been able to reinvent themselves. With iPod, Apple Computer Inc., whose strategic slips the authors scorch, provides a clear example of how managers sometimes have the power to blaze new trails.

As they analyze battles between such diminished warriors as Eastman Kodak Co. and Polaroid and comment on the still unresolved Home Depot Inc. vs. Lowe's fight, the core lesson from Greenwald and Kahn may be a truism—that for most companies the glory days almost never last. It's a warning even the most innovative would do well to contemplate. ■

–By Joseph Weber

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IdeasViewpoint

BY LAURA D'ANDREA TYSON

Those Manufacturing Myths

The U.S. economy has been recovering from the 2001 recession for almost five years, yet manufacturing employment is still down 10%, or 1.6 million jobs, from November, 2001. By contrast, manufacturing employment rose an average of 7.5% in previous recoveries that lasted as long as this one. What's behind the unprecedented weakness in manufacturing jobs? There are no simple answers, but some myths should be dispelled.

Manufacturing employment has fallen steadily as a share of total U.S. private-sector jobs, from about 35% in 1950 to under 13% today. The same long-term trend can be seen all over the world (even in China) and for the same reason: rapid productivity growth. In the U.S., an hour of work produced four times as much manufacturing output in 2000 as in 1950. But demand for that output, which would have had to grow as least as fast as productivity to support the proportionate creation of manufacturing jobs, hasn't kept pace.

The 2001 recession aggravated the mismatch between productivity and demand. Business investment, which grew unusually fast in the second half of the '90s, fell sharply, hitting manufacturing hard. Foreign demand for U.S. goods also declined because of a strong dollar and slowdowns in Europe and Japan. Meanwhile, imports continued to rise, and the trade deficit in manufactured goods ballooned. But contrary to popular belief, the combination of strong productivity growth and weak domestic demand—not the trade deficit—was the primary cause of lost manufacturing jobs during the past five years. And the major culprit behind the yawning trade imbalance was slumping exports, not surging imports.

Germany is losing jobs faster than the U.S., even with a large trade surplus

WHAT'S MORE, A TRADE SURPLUS in manufactured goods would not necessarily translate into job gains. The U.S. is the world's biggest producer of manufactured goods, but Germany is the biggest exporter, and it enjoys a large trade surplus in manufacturing even though it has been losing manufacturing jobs at a faster rate and has a much higher unemployment rate than the U.S. Germany's experience also shatters the myth that a high-wage economy is destined to run a large deficit in manufactured goods because of competition from low-wage countries. At the right exchange rates, with the right high-value-added products based on innovation, education, and productivity, high-wage countries such as the U.S. and Germany can still win commanding shares in global export markets.

Another misconception about manufacturing is that it provides better middle-class career opportunities for high-school grads than other sectors. This may have been so 20 year ago, but not anymore. Manufacturing still offers relatively high wage jobs vs. the rest of the economy. But as in other sectors, higher education is becoming critical. Harvard University professor Larry Katz, chief Labor Dept. economist under President Bill Clinton, notes that about half of all manufacturing workers now have some college, and almost 25% have college degrees. In manufacturing, college grads ear double the wages of nongrads even after adjusting for experience. But for nongrads, the wage gap between manufacturing and other jobs has narrowed to only about 5%. For such workers, manufacturing jobs are no longer a reliable gateway to a middle-class life.

Still, manufacturers provide a greater share o their hires with health insurance than other employers. About 56% of U.S. workers have health coverage through their jobs. But over 70% of manufacturing workers are covered, vs. only 52% in retail and wholesale jobs and only 30% in the recreation, hotel, and food sectors.

Recent evidence confirms suspicions that soaring health-care costs drag down job creation in U.S. manufacturing. Since 2000, sectors with above-average hikes in such costs, including manufacturing, have had slower job growth than other parts of the economy. A recent National Bureau of Economic Research study shows that rising health insurance premiums boost unemployment, push more workers into part-time jobs, and force employers to cut wages and other benefits.

What do the facts about manufacturing jobs imply for policymakers? Health-care reform to contain costs is a must. Technology policies to foster the creation of new products with strong demand potential and education policies to strengthen worker skills will help. Workers displaced from manufacturing should receive generous adjustment assistanc to move into new jobs. And trade policies should focus on expanding exports not on restricting imports. ■

Laura D'Andrea Tyson *is dean of London Business School (ltyson@london.edu).*

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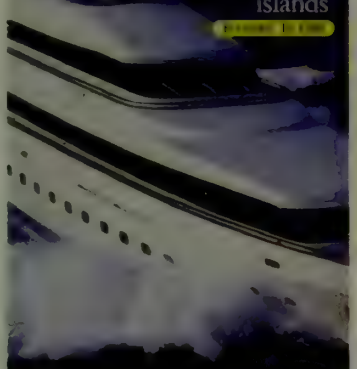

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Green Leaders Show the Way

THE GLOBAL WARMING debate has the potential to become a lot less acrimonious—and a whole lot trickier. For years environmentalists struggled against business executives, who complained loudly that the tremendous costs of cutting carbon emissions could hurt jobs and damage profits.

But at long last, some companies have discovered that reducing greenhouse gas emissions can make monetary sense, too. *BusinessWeek*, working with the Climate Group, Innovest Strategic Value Advisors, and independent experts, identified the companies that are the best-practice leaders in cutting their gas emissions. The list is led by DuPont, followed by BP, Bayer, BT, and Alcoa. DuPont, for example, has reduced its greenhouse gas emissions by more than 65% from the 1990 levels while using 7% less energy and producing 30% more product. The company's cost savings: more than $2 billion.

The success of these private sector leaders throws down a gauntlet, challenging both the environmental movement and the Bush Administration, which has consistently opposed mandated limits on carbon emissions. On the one hand, the fact that many major companies find they are able to lower their carbon emissions and their costs at the same time implies that government regulation of greenhouse gas emissions may not be as expensive as the Bush Administration fears. Moreover, establishing some sort of government regulations could speed up wider adoption of these corporate best practices, which in other cases have often taken years to spread across the economy.

DuPont, BP, Alcoa, and others have saved money while cutting emissions

On the other hand, the willingness and ability of leading companies to reduce their carbon emissions on their own suggests that voluntary action may be more effective than environmentalists have predicted. At least for the moment, the heavy hand of government may not be quite as necessary as it once seemed.

Instead, the correct next step for the public sector may be mainly informational. It shouldn't be a political problem for the Bush Administration to highlight environmental best practices and success stories—the companies that have been able to cut emissions and save money doing it. At the same time, the example of those leaders would help foster the growing consensus among businesses that we can find an economically and political viable set of standards—whether voluntary or mandatory—to turn back the damage and the continued threat of global warming.

Bush's Missed Opportunity

CHINA DODGED A BULLET on Nov. 28 when the Bush Administration decided against formally branding it a currency manipulator. Unfortunately, the Administration's mild rebuke of China's management of the yuan provides little practical relief for the small and midsize U.S. companies that must compete against goods priced in China's cut-rate currency. Even worse, the White House risks losing credibility with not just China but also the U.S. Congress, which may feel emboldened to pass protectionist legislation.

We appreciate the Administration's dilemma. The Chinese had already let their currency rise slightly this summer. So by cooling the currency rhetoric, the Bush Administration probably hopes to free People's Bank of China Governor Zhou Xiaochuan and other reformers to continue to let the yuan appreciate modestly in 2006, as some signs indicate.

Moreover, Chinese businesses are not the only beneficiaries of the low yuan. Many "Made in China" products consist mainly of components imported from other countries such as Japan, South Korea, or Taiwan and then assembled in China. And foreign-backed exporters, including China-based affiliates of large American corporations, reap big gains from China's undervalued currency.

Still, Beijing's official currency policy is the main enabler of this complex web of alliances, and U.S. policymakers must exert public pressure for more results like those of last spring. In its May, 2005, currency report, the U.S. Treasury warned China that it was likely to be designated a currency manipulator if it didn't substantially alter its exchange-rate policies. On July 21, China announced that it was permitting a modest 2.1% revaluation of the yuan against the greenback.

Although both sides provided lots of diplomatic cover for the shift, the truth is that China responded only after being threatened with the 'manipulator' label. Since the Treasury's latest currency report suggests that China's new exchange-rate system "remains, in practice, a tightly managed currency peg against the dollar," strong action still seems warranted.

That's why we think President Bush missed an opportunity to send a clear message that China, which is staking much of its near-term economic future on its exporting prowess, must play by global trade rules. Otherwise, the Administration's frequent assurances of the benefits of increased trade will continue to ring hollow with American workers.

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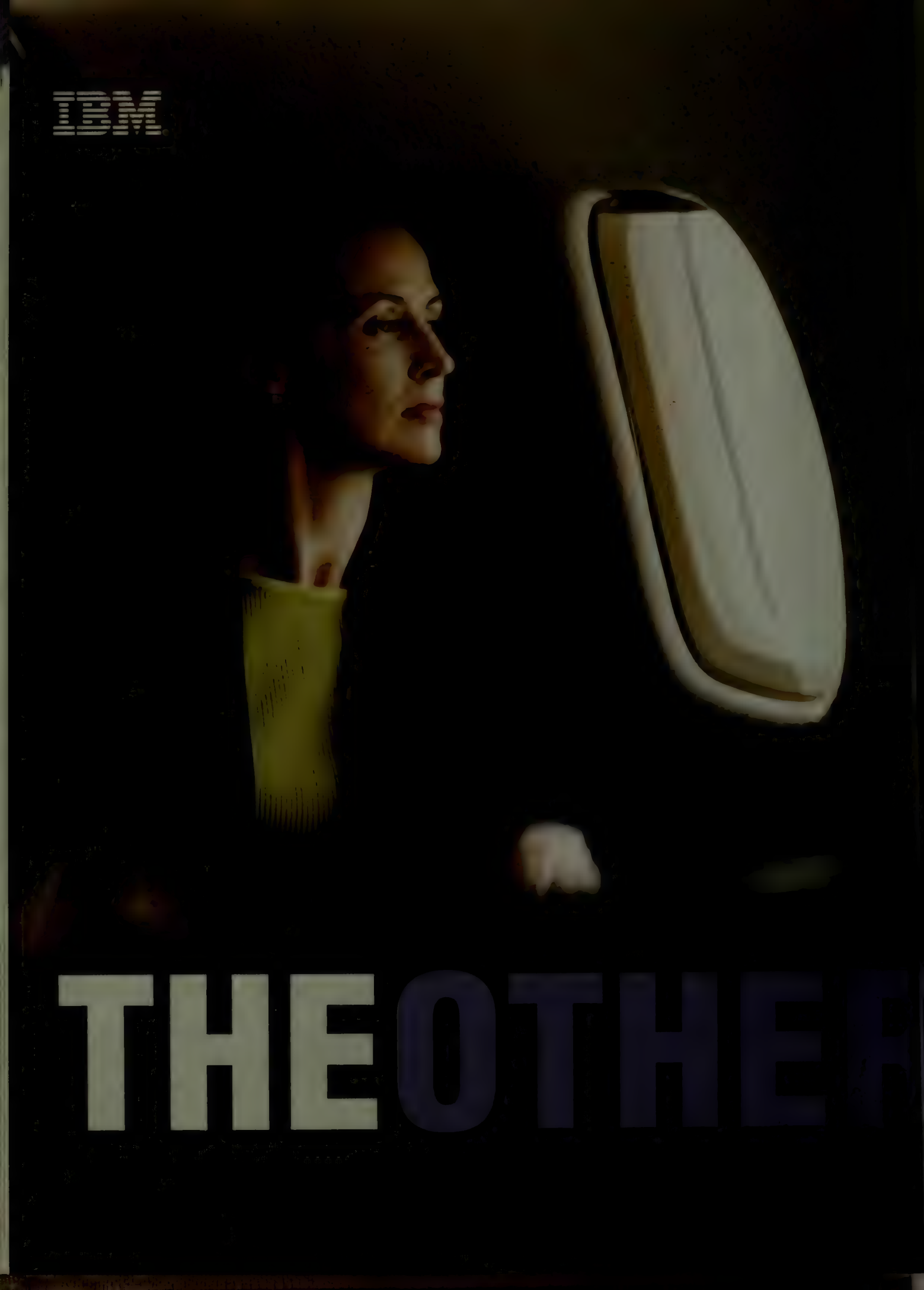

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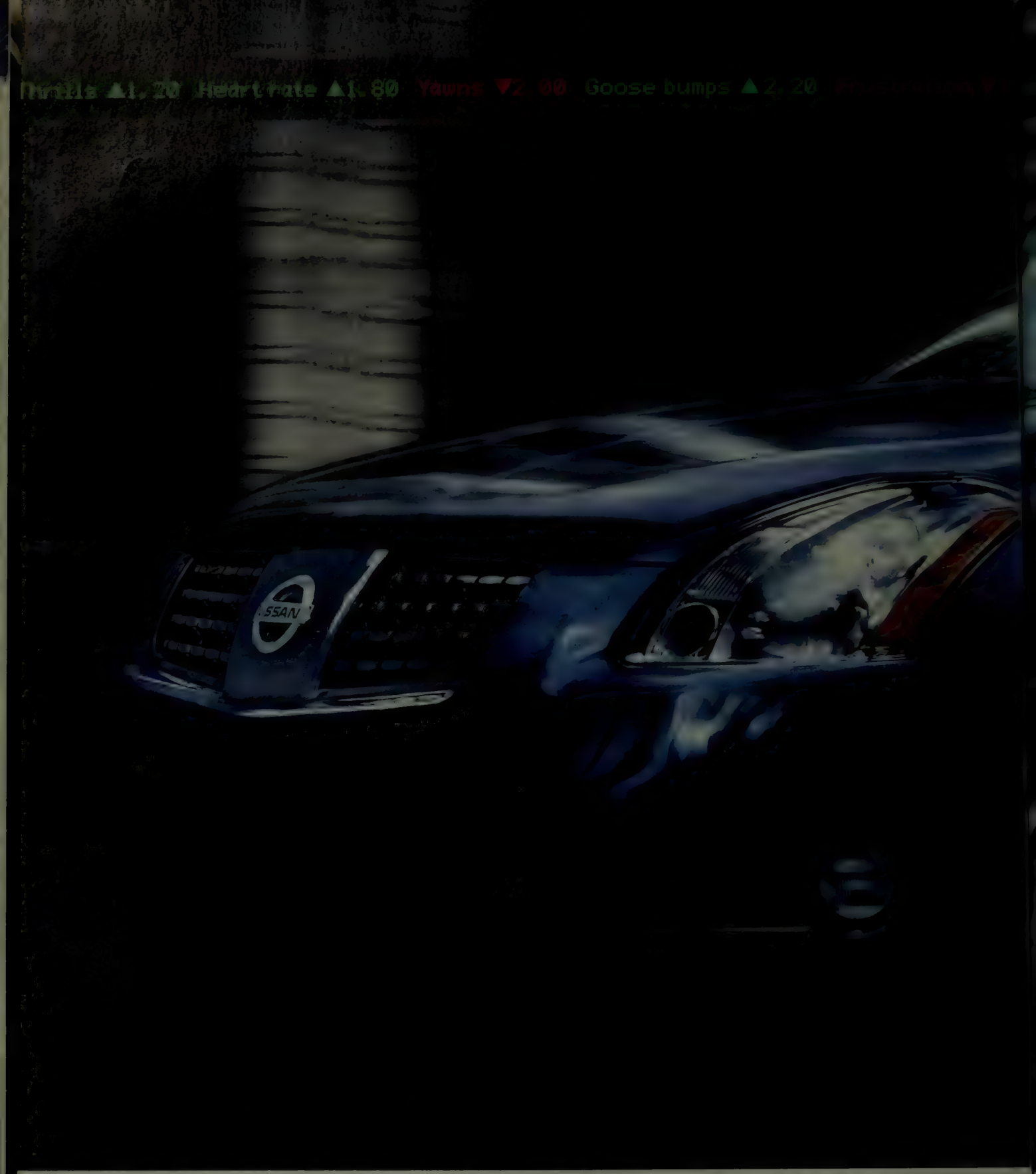

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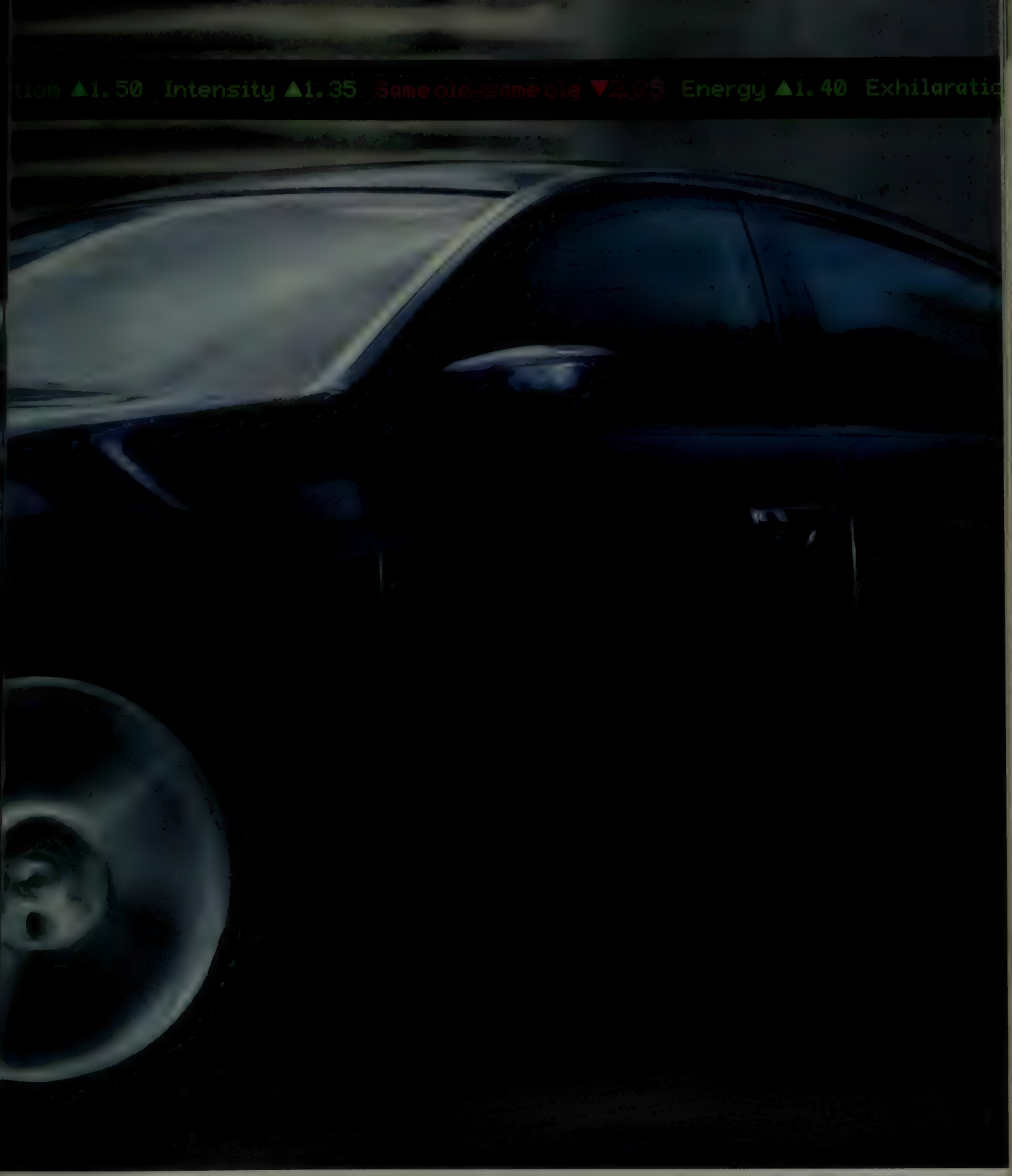

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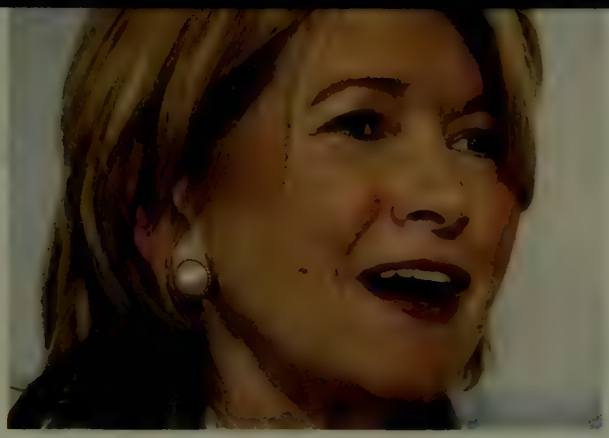

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Beyond Search: How Good Are Google's Other Offerings?

When we examined Google's Web search service, our reviewer said it's **still tops** in the business and gave it four stars (out of five). But what about the other kinds of services the Internet giant provides? Well, we've been busy trying them out and reviewing them, too, from **Gmail** ("a bit too quirky") to **Picasa** photo software ("way too many flaws") to **Maps** ("front of the pack"). Read 'em and see if you agree. Or add your own comments about what you like—or don't like—about all things Google

Tech Stocks March to The Beat of the iPod

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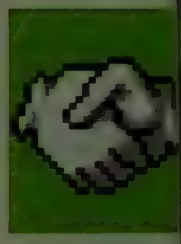
Mergers and Acquisitions: Back with a Vengeance



Deals in 2005 are likely to top $1 trillion, with the tech sector especially hot. As this analysis explains, ready cash, rapid technological change, and private funds make it unlikely we'll see any cooling soon

An Industrial Designer Who's Naturally Creative

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JP Front

"They've heard our concerns; they are acting on our concerns."

–Reverend Donald Wildmon on Ford Motor pulling some ads from gay publications under threat of a boycott

EDITED BY DAN BEUCKE

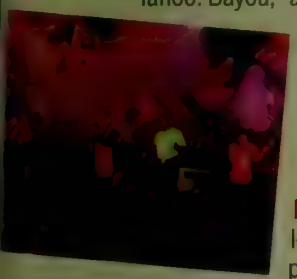
EXTREME PARTIES

DECK THE CORPORATE HALLS

Maybe it's the steady clip of corporate profits and sales growth. Or perhaps everyone just needs a breather after a year of pretty glum news about war, hurricanes, and earthquakes. But there's a feeling in the air we haven't seen in a long time about the company holiday party. Here's a sampler of bashes that'll probably be more interesting than yours:

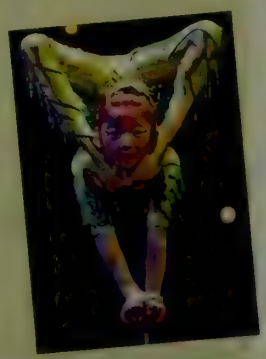
GOOGLE: Flush with hundreds of instant millionaires, Google commandeered Pier 48 on San Francisco Bay on Dec. 2. The theme: "Jetaway with Google Air." Multifarious rooms each portrayed a far-flung destination. Googlers drank and played darts with green-painted men in a Dublin-themed room, drank and sang karaoke in a Tokyo homage, and drank and danced in an ersatz London club. Details, fittingly, can be found all over the Web.

YAHOO! In a retro flourish, '70s funk act Earth, Wind, & Fire laid down the groove for about 7,000 employees (left). The theme was "Yahoo! Bayou," and Cajun cuisine seems to have sated the Yahoos in attendance. But one couldn't help gushing on a blog about the mashed potato bar, where caviar was a featured topping. A Yahoo rep assured us the band "rocked out."



NBC UNIVERSAL: Hollywood brass loves to reward worker bees with sneak peeks of hotly anticipated flicks. That's exactly what employees of NBC Universal, and "members of their immediate household," were promised: a Dec. 8 preview showing of Peter Jackson's much-awaited epic *King Kong*.

D.E. SHAW: Wall Street bankers are mum about what they will do with millions in bonus bucks. But we did learn that D.E. Shaw, one of the biggest hedge funds, will host Cirque du Soleil (right). Shaw owns FAO Schwarz and held last year's party at the retailer's famous Fifth Avenue location.



CDW: The computer seller is famous for its holiday parties, believed to be the largest in the Chicago area. It usually lays out $1 million for the event, flying in employees from various locations and putting them up for a weekend. This year? CDW will turn over its party budget to Hurricane Katrina relief.

–Brian Hindo

EXECUTIVE PERKS

Imagine Flying First Class Forever

WHILE DELTA AIR LINES and its pilots struggle over hundreds of millions of dollars in cuts to keep planes in the air, a former executive is fighting to keep her lifetime first-class flying privileges. Former Chief Financial Officer M. Michele Burns has asked a bankruptcy judge to protect that perk, which she negotiated for herself and her family before departing **Delta** in 2004. In September, Delta asked the court to reject all such arrangements with former execs. Burns is the only one to file a challenge, arguing in a Nov. 30 filing that Delta "will incur few or no actual costs or expenses" by continuing to provide free first-class travel on Delta planes because "there generally are empty seats on [Delta's] aircraft."

In 2002, Burns was one of 35 top Delta executives whose pension payments were guaranteed, even if the airline terminated employee plans. And the ill-fated decision to sell all of Delta's fuel hedges—just as prices began spiking—occurred on her watch. Burns, who became CFO and later chief restructuring officer at energy company **Mirant,** could not be reached for comment. But if Burns manages to keep her flight pass, she shouldn't expect a warm welcome from Delta workers on the ramp.

–Coleman Cowan

(CLOCKWISE FROM TOP RIGHT) STOCKBYTE/SUPERSTOCK; STEFFEN SCHMIDT/KEYSTONE/AP/WIDE WORLD; RANGELIFE.TYPEPAD.COM; ROGER KENNY

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UP Front

G BOX BLUES

AKING FEW RIENDS ON AIN STREET

L-MART STORES has been a charm offensive lately, ng to polish its image. The rt isn't playing in Peoria, vever. In that quint-ential American town, the z is all about the retailer's ny-pinching. Wal-Mart

de front-page news in vember by trying to cut its perty taxes in East Peoria. red by a five-year tax liday, the $288.2 billion mpany built a superstore in 1998 on what had been a vacant 19-acre lot. When the break expired, local authorities sent Wal-Mart a tax bill for $304,000 a year, mostly for local schools. Claiming its store's value has been overassessed, Wal-Mart is asking an Illinois appeals board to drop its levy by a third. A Wal-Mart official said the appeal is no different than a homeowner challenging a rising property tax bill. Harrumphed the *Peoria Journal Star* in an editorial: "The audacity of the world's largest company is breathtaking."

The tax flap comes only months after **L.R. Nelson,** a Peoria company that makes garden sprinklers, fired 100 full-time employees and sent their work to China. President Dave Eglinton says Wal-Mart wanted lower prices, and after Nelson lost its business with **Home Depot** to Chinese imports, the company couldn't risk a cutback by its biggest customer, too. *–Michael Arndt*

GAME PLAY

SONY, UNDER FIRE for spreading spyware on music CDs, is spreading graffiti, too. Spray-painted, bug-eyed kids playing with Sony PlayStation Portables (PSPs) started popping up in November on buildings in New York, Los Angeles, and other cities. The slightly creepy, logo-free images sparked Web rumors that rivals such as Microsoft were trying to make trouble. But a Sony official confirms it commissioned the ads from professional graffiti artists at New York agency TATS CRU. Some disgruntled residents have been defacing the images. But Sony seems to be in the clear this time: TATS CRU co-founder Sotero "BG 183" Ortiz says the outfit contracts for the spaces it paints. *–Elizabeth Woyke*

LOGSPOTTING

VATCHING... S THE WEB PINS

idcontent.org

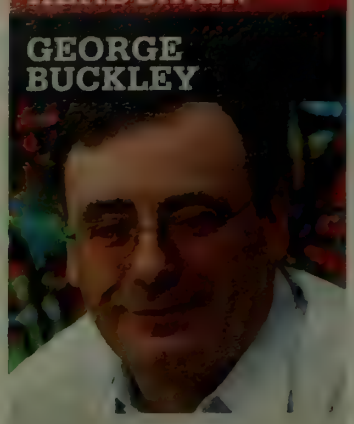
WHY READ IT: To track the tty-gritty of media and entertainment going digital. afat Ali and Staci Kramer mbine links to articles with iginal reporting.

NOTABLE POST: A confrontation between Tribune CEO ennis FitzSimons and Move-n.org, which thinks job cuts ndermine the press's watchog role: "[Noah] Winer tried give FitzSimons the box of etitions. Holding a tape corder, Winer asked repeatdly if he would meet with 'his stomers.' FitzSimons oked at him and said, 'No.'"

DRAWN & QUARTERED

UP Front

HEADLINER



THE NEW SKIPPER AT 3M'S HELM

For the second time in five years, 3M is tapping an outsider to fill its corner office. But this time the new CEO arrives with a lot less fanfare. On Dec. 7, 3M named Brunswick CEO George Buckley chairman and CEO. He succeeds James McNerney, who left St. Paul (Minn.)-based 3M last July to head Boeing. Before becoming the first outsider to lead 103-year-old 3M, McNerney was in the running to head up General Electric.

Buckley, 58, has a low profile even in the Chicago area. He joined Lake Forest (Ill.) - based Brunswick in 1997, from Emerson Electric, and rose to CEO in 2000. He beefed up Brunswick's pleasure-boat brands, which include Boston Whaler and Sea Ray. That helped to nearly double the stock price in three years.

But Brunswick is barely a quarter the size of 3M, which had sales of $20 billion in 2004. And lately, 3M has been hit by high materials costs. Buckley will have to figure out how to make this big boat gain speed. *–Michael Arndt*

I-WAY PATROL

HACKERS ARE FOLLOWING YOUR FINGERS

THEY'RE SILENT HUNTERS on your PC, stalking every Q, W, E, R, T, and Y as you type. Keylogging programs are the hottest tool used by cybercriminals to pickpocket bank accounts and personal data. The software is cheap, or even free, and widely available in underground chat rooms. Hackers and identity thieves have unleashed more than 6,000 unique keylogging programs in 2005, up from just 275 in 2001, estimates cybersecurity company **iDEFENSE.**

Most malicious keylogger software is installed remotely when unwary surfers visit corrupt Web sites or download applications such as file-sharing systems. It's programmed to send stolen info to databases, mostly offshore, where hackers sift through it for passwords, user names, and account numbers. "Keylogging can be used to steal anything," says Joseph Payne, president of iDEFENSE, a unit of network security outfit **Verisign.**

Indeed, the applications have been staggering. **WareSight,** a San Diego software company, sells 007 Keylogger Spy for $39.95. The motto on its Web site: "Investigate your spouse, kids, employees, and more..." One posted testimonial thanks the company for helping a husband find out his wife was sleeping with her boss. WareSight says its program doesn't steal anything because it's installed by the PC owner. In February, a student at Clements High School in Sugar Land, Tex., was charged with a misdemeanor for installing a keystroke decoder on the back of his teacher's computer. He recorded her typed answers to exams, deciphered them at home, and tried to sell them to other students. Another reason why handwritten notes may be the most secure way to communicate these days. *–Brian Grow*

RETAIL DETAIL

TOYS A LOT LIKE MOM'S AND DAD'S

TWEENS ARE TURNING UP their noses at toys. But **Hasbro** may have a winning strategy to lure back these 8- to 12-year-olds. Its researchers found they are fascinated with "toys" adults use—cell phones, video cameras, etc. But parents often won't spring for the real thing. "So we try to empower [the kids], but in a safe way," says Sharon John, general manager of Hasbro's Big Kids division.

Take the new ChatNow Communicator. The walkie-talkie looks like a cell phone and lets kids send text messages, take pictures, and call friends within two miles. Sales are so brisk that a bidding war broke out on **eBay,** where a set sold for $170—over twice suggested retail. Hasbro is also scoring with its $80 VCam Now video camera and I-Dog, a plastic mutt that adopts a personality when you plug in an MP3 player. *–William Symonds*

THE STAT

7

The percentage of CEOs who currently say they are blogging; 18% said they expected to host a company Web log within two years.

Data: Burson-Marsteller and *PRWeek* survey of 130 CEOs

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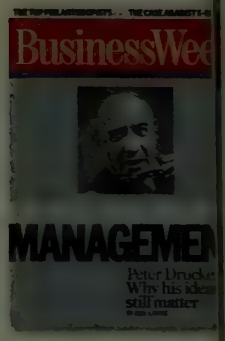
"[Drucker was] correct ...that modern corporate executives' greed will be the downfall of America's economic dominance."

–Gert Aron
Boalsburg, Pa.



PETER DRUCKER: PAYING TRIBUTE TO THE MAN AND HIS VISION

I SPENT EIGHT HOURS hiking in Colorado with Peter Drucker during the summer of 1986 ("The man who invented management," Cover Story, Nov. 28). As an IBM manager, I was initially awed being with the godlike guru who could not only relate conversations with Thomas Watson Sr. but also provide insights into just about any subject (e.g., overpaying "average" baseball players). But what struck me was that he felt he couldn't measure up within his own family—he didn't think he'd gained their respect. They were all accomplished scholars and here he was—gulp—in the business world.

We can take heart from this: You can still succeed even though you're not the most admired in the family.

–Dick Tunstall
Trumbull, Conn.

IT WAS DRUCKER who invented management. But Jack Welch didn't invent a long-standing General Electric Co. business guideline you give him credit for. When I joined GE in 1960, about the same time Welch did, the company had a comprehensive formal and informal manag ment development program. One princ ple taught in several of the courses w that GE should strive to be No. 1 or No in a market or business or get out. M training and tenure with GE took place the 1960s. My departure from GE was d rectly as a result of this dictum. GE's t management decided that it would n invest the half-billion dollars forecast reach leadership in the computer bus ness. Along with several thousand othe GE employees, I found myself employe by Honeywell Inc. in 1970.

–John Bla
Carefree, Ari

WHAT A WONDERFUL tribute to Pete Drucker. He was correct that the succes of a manager depends on putting the in terest of the organization and custome ahead of his or her own. He was also co rect in his prophecy that modern corpo rate executives' greed will be the downfa of America's economic dominance. Ho great would it be if his advice were heed ed so that no CEO could make more tha 20 times the income of a rank-and-fil employee? I would add one more sugges tion: a law that in no company that lack

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The entire department heard Bob exclaim, "Cool!" as he used the Web browser on the new imageRUNNER 6570 to access and print his company's 4th quarter sales results.

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ReadersReport

a sound health and pension fund can a director earn more than $100,000 a year.

–Gert Aron
Boalsburg, Pa.

EVIDENTLY, DRUCKER kept his conservative roots all the way through his life. I don't blame him for being concerned about golden parachutes. If General Motors Corp. had paid attention to his concerns, it wouldn't have ended up being close to bankruptcy. What took place only emphasizes the truth of the article "Small investors, sitting ducks" (Viewpoint, Sept. 12) by Robert Kuttner. All investors could be in real trouble if we don't pay attention.

–LaVern F. Isely
Monroe, Wis.

WE SHOULDN'T FORGET "the woman who invented management," particularly when Peter Drucker is said to have referred to her as his "guru": Mary Parker Follett (1868-1933). Rising to prominence as a management consultant in the 1920s, she is generally recognized as the originator of management concepts based on human relationships, teamwork, win-win solutions, leadership through shared purpose, and what would come to be called knowledge work.

–Matthew Shapiro
President
Mary Parker Follett Foundation
Boise, Idaho

YOU NOTE THAT Drucker was a teacher of religion and focused his later work on nonprofits, but there is something more explicit in his belief system: Drucker was a practicing Christian. He recognized that today's pastoral or "megachurches" are, in his words, "the most important social phenomenon in American society in the past 30 years." In the early 1990s he told religious leaders that the key question for churches is, "Can we create enough disciples?" While Drucker may have been Ronald Reagan-like in that he was not one to publicly declare his religious beliefs, from his famous humility to his desire to make a difference in people's lives, clearly Peter Drucker's Christian faith was a guiding source of truth in his life and work.

–Bill Getch
Roswell, Ga.

IT IS NOT SURPRISING that Tom Peters wasn't exposed to Peter Drucker in his PhD program. A few years after completing my MBA in 1964 and then my PhD at the Wharton School, I was assigned to teach a beginning management class at a major state university. Having been introduced to Drucker in the first business course I took as an MBA student at Wharton, I chose three Drucker books to constitute the course readings: *Concept of the Corporation, The Practice of Management,* and *The Effective Executive.* The students kept asking about the absence of a textbook and my colleagues thought "nonacademic" material should not be included in the course.

–F. Marion Fletcher
Statesboro, Ga.

CORRECTIONS & CLARIFICATIONS

In "Cat sinks its claws into services" (Corporation, Dec. 5), the value of a 10-year contract that a Caterpillar Inc. division, Cat Logistics, signed recently with General Motors Europe was incorrect. The contract will pay out nearly $100 million a year over 10 years, not a total of $100 million over that span.

In "Filthy rich, but froogle" ("Googling for gold," Cover Story, Dec. 5), we suggested that Carlo Panaccione, a high-net-worth manager, enrolled his daughter at a private school popular among Google Inc. families as a way to meet prospective Google-employee clients. In fact, Panaccione's daughter was enrolled at the school well before the Google initial public offering, and his family's association with the school goes back much further. We regret the misunderstanding.

In "I hear a symphony" (Technology & You, Dec. 5), the hard-drive capacity of the Symphony music player is 80 gigabytes, not 60.

In "The MySpace Generation (Cover Story, Dec. 12), *BusinessWeek* reported that Facebook.com is not profitable. A company spokesman says Facebook has been making money since January.

A FEW FAMILIAR WORDS GO A LONG WAY IN A WAR ZONE

YOUR BOOK REVIEW "Big Army just doesn't get it" (Books, Oct. 31) is right on the money. What will turn the tide in a deployment anywhere in the world is the interaction of one human being with another. This is done by voice. On the front in all actions are junior and senior enlisted personnel and junior officers. When will the brass get it and give these dedicated youngsters a basic (pick your number) 200-word vocabulary in the language of those they will encounter? Imagine being a U.S. soldier who is severely wounded, unable to move. A 5-year-old Iraqi boy walks by 10 feet away. If you can say "Help m in his language, you have a chance of l ing saved. The big brass (who are ne out in front) would prefer to skip the la guage training and have troops throw t kid a Hershey bar. Spend 30 days givi soldiers the ability to communicate w people? That's nuts. Make them bet marksmen? Hurrah!

–Leonard Tew
Hallandale Beach, F

THE DOWNSIDE OF PLAYING HOOPS IN THE SOONER STATE

RE "THE IMPROBABLE FLIGHT of t Hornets" (Sports Biz, Nov. 21): There one big problem for any NBA team pla ing in Oklahoma: One cannot legally g a tattoo in the state.

–Jim Gorma
Palo Alto, Cal

MORE PROOF THAT E-MAIL WASTES TIME AND MONEY

RE "E-MAIL is so five minutes ago (Working Life, Nov. 28): Responses co lected from our ongoing WhiteColl Productivity Index (WPI) survey of tim spent in the workplace indicate that t average executive in the U.S. is receivin 200 e-mails per day after spam is extrac ed and that 50% of those e-mails (agai after spam is extracted) are of no value t the receiver. Administrative and newe staff receive an average of 50 e-mails day, with about 30% being of no value.

The scary part is that all of these value less e-mails still have to be dealt with. S an organization of 1,000 people wi waste about 36,000 hours per year, at cost of $1.8 million in productivity, just t scan and discard these intrusions.

–Bary C. Sherma
Institute for Business Technology-US
Fallbrook, Cali

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Technology&You

BY STEPHEN H. WILDSTROM

Just Let Us Play the Movie

The flow of digital entertainment, held to a trickle for years by Hollywood reluctance to make content available, is rapidly becoming a flood. But all this new content, from TV shows on iPods to movies on a new generation of high-definition DVDs, has something in common: tough measures to restrict or prevent copying. ¶ The movie industry is united in its determination to avoid the mistake of record companies, which issued music in unprotected digital form—audio CDs—for 20 years, then watched as uncontrolled file sharing wrecked their business model. The technology to control copying, known as digital rights management (DRM), exists and, if handled carefully, can protect the interests of both content owners and consumers. But the chances that it will be implemented in a way that considers consumers' needs are slim.

The recent fiasco involving copy-protected CDs from Sony BMG Music Entertainment showed how casually the industry can trample over customers. Playing the disks on a PC required installing a program that every security company classified as spyware and that rendered computers on which it was installed vulnerable to third-party attacks. Sony BMG now faces a consumer revolt and a slew of lawsuits.

THE SONY BMG AFFAIR is a model of how not to implement DRM. The company made three fundamental mistakes: It was sneaky, relying on the fine print of an end-user license agreement on the screen to list various important restrictions. (These included a bizarre condition that prohibited playing the music if you had filed for bankruptcy.) Sony also added features not needed for the DRM to work—one of which secretly sent information back to Sony BMG. And the company made no attempt to comply with any sort of industry standard, bypassing scrutiny that might have brought the flaws to light and requiring the consumer to install DRM software just to play a specific CD.

This was an extreme case of DRM gone bad. The much larger challenge facing consumers as digital media proliferates is system incompatibility: the scourge that limits which hardware and software you can use to play what content. Consider the TV shows available for $1.99 from Apple's iTunes Music Store. These are protected by Apple's FairPlay DRM and can only be watched on an iPod or on a Mac or Windows PC with Apple's iTunes player.

Let's say you have a Windows Media Center PC linked to your TV with some episodes of *Desperate Housewives* stored on the hard drive. Because iTunes won't work through the Media Center software, you'll have to switch the Media Center to regular Windows mode and trade your remote for a mouse to see the shows. Even so, you're better off than a Mac owner who wants to download a show from Movielink: The service's DRM software works only on Windows PCs.

Content protection should not make life hard for consumers

Situations like this, together with the Sony BMG mess, have given the whole concept of DRM a bad name. To win public acceptance, the industries involved—content, information technology, and consumer electronics—are going to have to put maneuvering for advantage aside and stick to clear, consumer-first goals. Above all, users should not have to notice the existence of the particular DRM as long as they abide by clearly stated copying limitations. Digital content should use standard DRM technology built into players such as iTunes and Windows Media Player. And any content should play on any device that can physically display it, without regard to operating system.

The entertainment industry has a great opportunity for new markets, and the PC and consumer-electronics industries have an opening for new products. But realizing this potential will require all of them to show some respect for their customers. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

You Read It Here First–and Last

Many exciting things will happen in media and marketing in 2006. The following items will not be among them. In a more delightful world, all of these reports would clack across news wires everywhere—that is, if anything still clacks across a news wire anywhere. In the current reality, you can call these the five best media stories you won't read in 2006.

(NEW YORK, JAN. 23) Moving boldly to remake its nightly newscasts, CBS News today made the surprise announcement that Borat Sagdiyev, the Kazakhstani character portrayed by humorist Sacha Baron Cohen on HBO's *Da Ali G Show*, will succeed Dan Rather as its evening news anchor. "Mr. Sagdiyev is a dynamic, fearless reporter who epitomizes CBS's fresh new approach," said a spokesman.

Many observers were flummoxed, since CBS gave no indication of understanding that Sagdiyev does not, you know, exist. Others expressed different concerns. "Having a fictional character read real news will severely impact the credibility of broadcast journalism," says Frank Discussion, chief editorial officer of the Edward R. Murrow Center for Literal-Mindedness in Reporting. An interview with the crude-spoken Sagdiyev, whose signature trait is extreme social inappropriateness, yielded no comment suitable for this publication.

(WEST LAFAYETTE, IND., MAY 16) Sony suffered another public-relations black eye today when a copy of anti-piracy software embedded onto Sony BMG CDs was charged with bludgeoning a Purdue University student. Clem Kruczynski, 20, was hospitalized with a concussion after attempting to load former Phish front man Trey Anastasio's 2005 album, *Shine*, onto his PC. After a brief struggle, campus security subdued the software and took it into custody. Kruczynski's roommate, DeWitt Clinton, expressed bewilderment over the attack. "What's a CD?" he asked.

(DUBLIN, AUG. 2) Analysts predict a wave of consolidation will reshape the music industry after noted rock group U2 completed a hostile takeover of David Bowie. Although no announcement was made, it is expected that Bowie's duties as David Bowie will be assumed by U2 singer Bono. (Bono appeared at a post-announcement press conference wearing a wig that resembles Bowie's hairstyle and imitating Bowie's accent, which visibly confused the rest of his band.) U2's excruciatingly politically correct bona fides belies the band's fierce ambitions. Executives close to the situation said U2 was "actively pursuing" acquisitions of Eminem, the Yeah Yeah Yeahs, Usher, and Shania Twain, each of which would significantly diversify U2's musical portfolio.

(LOS ANGELES, OCT. 20) Executives at Warner Bros., Fox Searchlight, and DreamWorks jointly announced today that they would reduce the time between films' theatrical and DVD releases—known as "the window"—and will begin issuing movies on DVD in advance of their completion. A studio executive denied the move was related to last week's news that U.S. cinema chains will remove seats from all theaters and convert them into venues for interactive video-gaming.

Google searches minds. U2 mounts a hostile takeover of David Bowie

(SAN FRANCISCO, NOV. 14) Google has kept mum on reports that it's readying brain-search application GoogleYourMind. But a bizarre incident during a press briefing with CEO Eric Schmidt today gave ammunition to observers who ascribe supernatural powers to the leading search engine. "I know what you're thinking, and it's not funny," snapped the usually soft-spoken Schmidt following a question from a CNET Networks Inc. reporter about GoogleBaseTen, the company's bid to make mathematics more efficient. Schmidt's PowerPoint presentation was then interrupted, and an onstage screen alternately displayed a three-dimensional brain image—later confirmed to correspond to that of CNET's reporter—and the phrase "At least they can't search this." The reporter, initially stunned into silence, sprinted from the room after a lengthy list of his "hottest celebrities" appeared on screen. ■

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Which begs the question: What's a

mails

THE FLOW OF MAIL, documents and packages has become increasingly diverse, containing everything from bills and e-statements to direct mail and goods like DVDs.

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BY ROBERT BARKER

Hot Bets in the Cold North

It was 1969, and The Youngbloods were on the radio all the time: "Come on people now/Smile on your brother/Everybody get together/Try to love one another/Right now." Today, "Get Together" is on TV in an American Petroleum Institute ad for more drilling, plus conservation. This latest devolutionary leap by baby boomers softly screams how anxious we are about oil and natural gas—and the unconventional lengths we'll go to tap fresh sources.

Unconventional here is the key word, as in the hard-to-reach and less-exploited geologic formations known collectively as unconventional gas: so-called tight-gas sands, shale gas, icelike gas hydrates, and most of all coalbed methane, or CBM. Development of CBM reserves could hardly be hotter right now, particularly in Canada, where unconventional sources still produce less than 10% of gas output, vs. about one-third south of the border. Greg Melchin, Alberta's Energy Minister, told me that more than 3,000 CBM wells have been drilled in his province during 2005, about as many as existed a year ago and roughly 15% of Alberta's total drilling in 2005.

ALBERTA COALBED A drilling surge

DEVELOPMENT OF unconventional sources of oil, such as Alberta's Athabasca tar sands, seemed a distant prospect just four years back. Since then, tar sands producers have flourished, with the likes of Suncor Energy seeing their share prices quadruple in value. Are CBM producers on their way toward similar mega-gains? Doubtful, I would say, if only because many—EnCana and Quicksilver Resources, for two already have seen their stocks jump in 2005 with the energy sector, up 69% and 79%, respectively. Also, for all of CBM's fast growth, it's still a small piece of most drillers' output.

Just the same, companies producing CBM in Canada look like a good bet to me, because they are in the early stages of exploiting this resource, whose long-term payoffs could stretch over many years (table). Those companies—and investors—forgoing CBM figure to be disadvantaged. Research into extracting gas from coal has been going on for decades and was promoted in the U.S. via a tax credit passed in 1980. The recent surge in gas prices is pushing the industry. The Canadian Society for Unconventional Gas (CSUG) held its annual meeting in November, with more than 1,000 attendees, up from just 150 or so seven years ago.

Besides EnCana and Quicksilver, other big public companies doing the most CBM development in Canada include Calgary-based Nexen and Apache, which is headquartered in Houston, CSUG President Mike Dawson told me. He expects 2006 will bring even more CBM drilling, with up to 5,000 new CBM wells. As with most resource-based stocks, these will be volatile because of fluctuations in the commodity prices. Worse yet, the near-term market for gas is linked inextricably to the weather, a huge imponderable. Opportunistic investors might find a chance to get into these stocks if this winter's weather is warmer than expected, taking natural gas stocks down seasonally.

In any case, the expertise in extracting unconventional gas that these companies have developed should serve long-term investors well. Melchin, Alberta's Energy Minister, noted that his province to date has produced some 130 trillion cubic feet of gas and counts an additional 100 trillion cubic feet in conventional reserves. Alberta's coalbed methane reserves are estimated at 500 trillion cubic feet. An auction for mineral rights there, set for Dec. 14, is shaping up as the biggest ever. While only a fraction of total CBM resources eventually will be extracted, it's hard to see CBM not being a big moneymaker. "The extent of the play," Melchin said, "is only beginning to be examined"—and figures to ease our energy anxieties. ■

E-mail: rb@businessweek.com

Unconventional Gas Producers

COMPANY/SYMBOL	PRICE*	52-WEEK RANGE
Apache APA Alberta pioneer, with its first CBM well in 2003	$68.54	$78.15-47.45
EnCana ECA Growth in total gas output being driven by CBM	48.13	69.64-31.57
Nexen NXY Investing $345 million over next 18 months	47.21	60.67-23.55
Quicksilver Resources KWK Pure play on unconventional gas in North America	44.00	50.20-21.58

*Dec. 5 **Data:** Company reports, Capital IQ

JAMES C. COOPER & KATHLEEN MADIGAN

Can Productivity Keep Up the Good Work?

must stay on track with pay gains to hold inflation at bay

U.S. ECONOMY As economic forecasters begin to take a serious look at prospects for 2006, some key themes are emerging. One is the economy's resilience at the end of 2005 and how that will play into inflation and Federal Reserve policy. Another is the indication of a slowdown in housing and how that will affect home prices and consumer demand. And wild cards are on everyone's mind, from energy prices to the dollar to Wall Street's relationship with soon-to-be Fed Chairman Ben S. Bernanke.

However, the sleeper issue of the year could well be productivity. The influence of increased productivity on the upswing in business over the past four years has been enormous. Since the recession ended in the fourth quarter of 2001, growth in productivity has averaged 4% annually. That far exceeds the pace in any similar period since the 1960s and partly explains the "jobless recovery" of this upturn. But even in the first six quarters of this recovery, when payrolls fell by more than 1 million workers, the economy still grew at a 2.1% annual rate. Productivity's heady clip also generated income growth for both workers and businesses, while keeping upward pressure off inflation.

Of course, in the past two years, the contribution of productivity to overall economic growth has decreased, while the share coming from additional hiring has picked up. Therein lies the crucial question for 2006: How much growth will come from productivity gains, and how much from job growth? Given the tightness of the labor markets in November, the outlook for both inflation and interest rates might well hang in the balance.

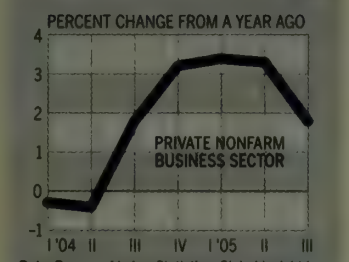
THE ROBUST TREND in productivity looks encouraging for inflation prospects, at least for now. Output per hour worked at nonfarm businesses in the third quarter jumped at an annual rate of 4.7% from the second quarter, and it was up 3.1% from a year ago.

Some of last quarter's surge reflected work time lost in areas affected by Hurricane Katrina. Hours worked rose at a mere 0.1% annual pace, after growth averaged 1.7% in the first half. But even adding back the lost work time, productivity still would have posted an impressive gain.

The current trend suggests that businesses are holding the reins firmly on their unit labor costs, which is perhaps the most important influence on company pricing decisions and thus the inflation outlook. Unit labor costs fell 1% last quarter, and over the past year they have grown only 1.8%, much less than the rise in prices, which explains why profits margins have remained very high.

What's especially encouraging is that the growth in unit costs has slowed sharply from its pace earlier in the year (chart). That pickup is proving to have been a blip caused by a surge in 2004 compensation related to the payout of stock options and bonuses, which pushed up unit costs at a 7.6% annual rate in the fourth quarter of 2004. That pattern might recur this quarter, given the Street's record bonuses. In addition, based on new tax data, the government revised down its estimates for the growth in basic wages and salaries earlier this year. The change meant unit labor costs fell in the second quarter, instead of rising as first estimated.

UNIT LABOR COSTS LOOK TAMER



Data: Bureau of Labor Statistics, Global Insight Inc.

The tamer pace of unit labor costs will most certainly play favorably into the Fed's thinking about interest rates at its Dec. 13 policy meeting, especially since that cooling-off is accompanied by a slowdown in the Fed's preferred measure of inflation. In October, inflation measured by the price index for consumption expenditures, excluding energy and food, rose only 1.8% from a year ago. This gauge has been falling since hitting a peak of 2.3% in November of last year, and it is now firmly within the stated 1%-2% "comfort zone" of incoming Fed chief Bernanke.

BUT THE REAL FOCUS of Fed officials will be on how the labor markets and productivity will play out in 2006. Despite the recent good news on productivity, the trend in output per hour has slowed—even if from its spectacular pace earlier in the recovery. With the economy expected to grow about 3.5% this quarter, and with hours worked through November growing in the 1%-1.5% range, productivity this quarter seems likely to slow to about 2%.

That comes amid signs that hiring is strengthening and wage growth is picking up. The danger for 2006: Pay gains that are not offset by advances in productivity

will feed straight into unit labor costs, threatening to fuel inflation.

The November employment report showed that job markets continue to tighten amid growing signs of shortages of skilled labor. Job growth is bouncing back strongly from the Katrina and energy-related slowdown in jobs in September and October. Businesses added 215,000 new workers last month, after increases of only 17,000 in September and 44,000 in October. Prior to Katrina, 2005 job gains had averaged 195,000 per month.

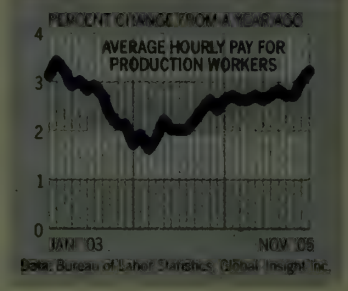
Post-hurricane rebuilding and recovery was one factor in last month's strength, but not the only one. High tech was a leader in the gain in factory payrolls, which were up for the second month in a row. Factory jobs have not posted back-to-back gains in 1½ years. Business services added 29,000 workers. Overall, the November increases were the broadest across industries since May, 2004.

Larger job gains could be on the way. In November, the number of persons saying they were not at work due to bad weather remained at a high level that was atypical for past Novembers. More important, recent readings on jobless claims are consistent with much larger payroll gains. Through November, claims other than those storm-related were even lower than prior to the storms.

NOT SURPRISINGLY, given that the unemployment rate is already at a low 5%, wage growth is beginning to pick up. The Fed's Nov. 30 Beige Book, a summary of regional economic conditions prepared for the upcoming meeting, reported at least modest upward pressure on wages with a "more substantial" push in the Fed districts of Bosto Richmond, Atlanta, and San Francisco.

In November, nationwide hourly pay of production nonsupervisory workers rose 0.2% from October, wher they had jumped 0.6%. Some of that large average gai was skewed by more jobs in higher-paying industries, such as construction a manufacturing, that w boosted by the storm cleanup. However, the yearly pace of hourly p has been accelerating since early 2004, when reached a low of 1.6%. November pay was up 3.2% from a year ago, t fastest clip in more tha 2½ years (chart).

WAGE GROWTH IS HEATING UP



Wage gains should g larger in 2006, given h tight the labor markets are. Whether or not those raises are inflationary will depend on productivity. Strong gai in efficiency partly explains why job growth has been healthy but not booming, and why prices outside of energy have remained tame. However, with economic growth expected to stay healthy in 2006, productivity w have to keep rising about 2% to continue the balance between job growth and inflation pressures. If productivity falls short of the 2% mark, policymakers at the Fed will start to get nervous. ■

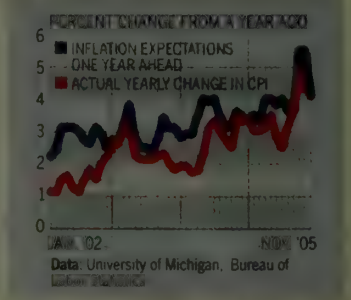
INFLATION

How Not To Forecast Price Hikes

CORRECTLY GAUGING the future is one way economists and investors measure their success. Both groups look for a statistical connection between current data and future trends. But sometimes what worked in the past no longer holds up.

That seems to the case with inflation expectations, as measured by the University of Michigan's Index of Consumer Sentiment and the actual experience of prices. Anthony Chan, senior economist at JPMorgan Fleming Asset Management, studied the link between the consumers' mean forecast of inflation one year out and the reported consumer price index compiled by the Bureau of Labor Statistics. What he found was that expectations did a superb job of forecasting the CPI in the 1980s, explaining 86% of the change in the index. By the 1990s the forecast data could explain only one-third of the actual inflation. And in this decade expectations tell you almost nothing about how inflation will actually turn out. For example, before the runup in energy costs, consumers surveyed in late 2002 thought inflation in the coming year would run close to 3%. Instead, prices over the course of 2003 rose only 1.9%.

DO CONSUMERS' EXPECTATIONS MATTER?



Consumers' inability to forecast the CPI correctly may seem odd given that, on a daily basis, they confront the price changes measured in the monthly BLS report. What's happening? Chan says consumers have not yet accepted tha globalization and higher productivity have made the economy more inflation-resistant. That's true even though one piece of evidence on this new inflation resistance is consumers own behavior. Chan points out that when shoppers face a higher price fo a domestic good, they frequently switch to a cheaper import.

This study sends an important warning about blindly following rules of thumb that worked in the past. Because the link between inflation expectations and actual inflation was so strong in the 1980s, investors and economists have become used to relying on it to forecast inflation. Chan thinks the relationship will reassert itself as consumers adjust their thinking. But for now consumer expectations about prices seem to be ignoring the new economic order. ■

–By Kathleen Madigan

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The Business Week

News you need to know

EDITED BY HARRY MAURER

The Tussle For Guidant Oh no, you don't. Just when **Johnson & Johnson** finally had its torturous takeover of Guidant settled, **Boston Scientific** spoiled it all on Dec. 5 with a bid for the cardiac-products maker. The $25 billion offer amounts to a gutsy gamble. Guidant is under investigation for a series of recalls of defective defibrillators (photo) and other implanted devices, which was why J&J dropped its price to $21.5 billion last month. Boston Scientific execs concede they can only guess at how badly the inquiries will hurt Guidant. By jumping in, management is also granting that its mainstay business—cardiac stents—can't grow fast enough to satisfy investors. So if J&J joins the bidding war, Boston Scientific has a powerful incentive to up its offer.

The bid is no doubt causing palpitations at J&J. Boston Scientific's chief rival in stents also needs a new business to perk up its numbers now that drug sales are slowing. But J&J walked away from its original $25.4 billion deal by claiming Guidant was ailing, so it would have a hard time flip-flopping to offer more. Although Guidant's reputation is wounded, the company looks like the big winner.

See "M&A: Back with a vengeance," www.businessweek.com/go/tbw

Courting AOL And then there was one? **Time Warner** on Dec. 7 appeared on the verge of eliminating either **Microsoft** or **Google** and beginning exclusive talks with the other on a partnership with former ugly duckling **AOL**. Insiders give the edge to Microsoft, which wants to merge the advertising functions of its **MSN** unit with AOL's and replace Google as its search engine. Google is exploring a similar deal. The idea of selling a chunk of AOL may have died. "AOL is not for sale," Time Warner CEO Richard Parsons told reporters before a Los Angeles speech on Dec. 6. It says the Net service this year will generate nea $2 billion in operating income. Take that, Carl Icahn.

See "For AOL, it's decision tim www.businessweek.com/go/t

The Big (Public) Board Seat owners of the **New Y Stock Exchange** voted on Dec. 6 to become shareholders stead. Some 95% of the 1,307 owners who voted gave thumbs-up to a deal that will turn the NYSE into a pub company and move it away from floor-based to automat trading, which could put "specialists" out of work. It clea the way for the Big Board to acquire **Archipelago**, the pu licly traded Chicago electronic exchange. Arca's stock w be renamed for the NYSE and will hit the market as soon next month. While floor traders could lose 75% of their a tion within a year, they're crazy like foxes. They know t Big Board must diversify and automate in order to win t death struggle with **NASDAQ** and foreign bourses.

See "NYSE-Arca: Think global, fight local www.businessweek.com/go/tb

A Widely Watched Case The Supreme Court will tal a crack at defining job retaliation by way of a case again **Burlington Northern & Santa Fe Railway**. It reassigned track la borer Sheila White to less desirable work, then temporari suspended her without pay after she complained of sexu harassment by her supervisor. Federal law bars companie from retaliating against workers who raise discriminatio claims, but the railroad says that means only "ultimate actions, like firing or demotion. Some courts agree. Other including the Sixth Circuit Court of Appeals, which uphel a $43,250 jury award to White, apply a more employee friendly test. Enter the Supremes.

Auto Axmen More loud noises from the Detroit auto body shop: **GM** on Dec. 5 startled the industry by announc ing that **CFO John Devine** would turn over the wheel o Jan. 1 to **Frederick "Fritz" Henderson**. Devine, 61, will stic around for a year as vice-chairman. Henderson, 47, ha steered the GM units in Latin America, Asia, and most re cently Europe, leaving a highway of closed plants, job cuts and some tidy turnarounds behind him, so he'd seem to be just the guy to help remodel in North America. Meanwhile on Dec. 7 the *Detroit Free Press* said that **Ford's** makeove plan, to be unveiled in January, will entail more pain than expected: 30,000 jobs and up to 10 plants will go the way of the Edsel. Ford executives declined to comment.

See "GM's way or the highway," page 48

The Weak Yen Even though the Japanese economy is awakening from its 10-year hibernation, the yen is swooning. The dollar reached 121.39 yen on Dec. 5, its top level since March of 2003. The Japanese currency also marked record lows vs. the euro. What gives? For one thing, the spread between rates in Japan and the U.S. is the widest in four years. While the **Bank of Japan** no longer dreads deflation, it has been slow to hike rates from near zero, while

U.S. and European central banks have been tightening. t makes U.S. and euro zone bonds more juicy to in- ors. But don't expect Tokyo to try and halt the slide. re's nothing **Sony**, **Toyota**, *et al* love better than a sag- g yen, which makes their products cheaper abroad and sts the value of profits brought home.

See "The dollar is still defying gravity," BW—Dec. 12

ge Worries Solid GDP numbers. Terrific productivi- growth. Tight labor markets. Real wages must be go- up, right? Well, no. Output per hour in the nonfarm siness sector rose at a 4.7% pace in the third quarter, fastest since 2003, according to a government report eased on Dec. 6. And 27 states and many of the biggest tro areas, including New York, Los Angeles, Philadel- a, and Dallas, have jobless rates below 5%, spurring reports of labor short- ages and some heat under wages. Yet after adjusting for infla- tion, pay has dropped more than 2% over the past year, with managers and profes- sionals slipping just as much as other rkers. It's unclear whether global competition is final- catching up to Americans, but the problem doesn't em to be going away.

See "Can productivity keep up the good work," page 25, and "Americans, working longer for less," www.businessweek.com/go/tbw

x-Reform Dreams Deferred? Once upon a time, e White House had grand ideas for tax initiatives this ar and next, but those dreams are fizzling in the face of ality on Capitol Hill. As BusinessWeek Online first re- rted, the Administration signaled in October that it ould abandon for now its push to extend low rates on pital gains and dividends, so it's unlikely Congress will t on that this year. The rates were trimmed in 2003 rough 2008. White House aides are now hinting that **esident George W. Bush** won't push broad-based reform of e tax code in 2006, even though a handpicked commis- on suggested such changes in November. The delay ould effectively doom reform efforts until a new Presi- ent is sworn in. But Capitol Hill may give as many as 16 illion taxpayers one hotly desired holiday gift—another ear's escape from the saber-toothed Alternative Mini- um Tax.

dia Lures More Investment In case there was any ubt, tech titans believe in India. On Dec. 7, **Microsoft airman Bill Gates** laid out plans in New Delhi to invest $1.7 llion in India over the next four years. That followed a ec. 5 **Intel** statement that it would spend $1 billion in the untry over five years, and the October news that **Cisco** ould drop $1.1 billion there over three years. The compa- es are expanding operations to take advantage of a work- force that is both highly educated and low-cost. In addition, Microsoft is looking to stave off the growing threat of **Linux**, the open-source operating system that has made giant strides in India. The company plans to create versions of Windows in several of India's many languages.

See "AMD's Asian thrust," page 45, and "Intel's eager passage to India," www.businessweek.com/go/tbw

Airplane Orders Fly High Skies can't get much bluer for **Airbus** and **Boeing**, at least as far as orders go. The two seem headed for a record year, and Boeing still leads the race, with 800 official sales booked vs. 687 for Airbus as of Nov. 30. But Airbus won preliminary commitments this week to sell 150 aircraft to China, 18 to **Germanwings**, 9 to **Finnair**, and 9 to **Philippine Air**. When contracts are signed for those deals, and for agreements scored earlier by Boeing, the official total will soar past the 1,600 orders booked in 1989. Even better: **Qantas** and **Singapore Airlines** have yet to weigh in.

See "The battle for China's lucrative skies," www.businessweek.com/go/tbw

Yellow Pages for Sale When you think of yellow pages, you don't exactly think, "Sexy!" But check this: **Verizon's** directory business rang up revenues of $3.6 billion last year—and profits of nearly $1 billion. That's why, when the telecom behemoth on Dec. 4 said it would take calls about **Verizon Information Services**, the Street guessed it might draw a passel of suitors and a lavish price of $13 billion to $17 billion. For Verizon, it's all part of the metamorphosis from a low-growth phone company into a zippy purveyor of broadband and wireless.

See "Yellow fever, courtesy of Verizon," www.businessweek.com/go/tbw

Blockbuster of the Week

Can a love-struck ape bring good things to life for **GE** on Dec. 14? Already getting heady buzz as—of all things—a romance, **Peter Jackson's *King Kong*** has to do some monster business for GE's **Universal Pictures** to recoup the $207 million it spent to make the film and nearly $50 million to market it, especially with Jackson getting 20% of the gross. Marketers have left no tie-in untied: **Kellogg** boxes of **Apple Jacks** and **Corn Flakes** with Kong. Same for 10 million **Nestlé Crunch** and **Butterfinger** bars. A **Chase MasterCard**. A Kong video game from **Ubisoft** (again, Jackson gets a big bite). A special **King Kong Millions** New York State lottery. GE certainly needs the big guy: Ratings at its **NBC** network have been tanking for two years, ***Today*** anchor **Katie Couric** is considering a jump to the ***CBS Evening News***, and Universal has misfired this year with highly anticipated films like ***Cinderella Man*** and ***Doom***. All that could vanish in the mists of Skull Island with a box-office roar from a computer-generated primate.

REAL ESTATE

BUBBLE, BUBBLE—THEN TROUBLE

Is the chill in once-red-hot Loudon County, Va., a portent of what's ahead?

BY PAUL MAGNUSSON AND STAN CROCK

PSSSSSFFFFFFT. THAT'S the sound of the air finally leaking from the real estate bubble in Loudoun County, Va. Since 2000 it's been the nation's fastest-growing county, where eager homebuyers always seemed to outnumber happy sellers. Until now.

Bob Semmens, a 60-year-old retired pressman, has heard that sound. After he offered up his 3,000-square-foot colonial, with three acres and a swimming pool, in early July for $759,000, he sat back to wait for the frenzied offers. A year before, houses had remained on the market for just 20 days and were snapped up in bidding wars. But "very few people were even coming out to look," Semmens recalls. After four months, he was about to take the house off the market until next spring. But then he struck a deal—for $620,000, an 18% price cut. Semmens rues his bad timing: "Just at the time I was getting the house on the market, everything really started to slow down."

By October, agents had 2,908 existing Loudoun houses on the market, an increase of 127% over a year earlier. The average time on the market had climbed 62%, to 42 days, since the fall of '04. And in just two months, from August to October, the median sales price for houses dropped from $506,100 to $480,000. In kitchens and coffee shops from Purcellville to Leesburg, anxious homeowners swap stories about a market rapidly going soft: The real estate agent who gets 10 to 15 e-mails a day from developers now offering price cuts of $10,000 or more to move new houses. The sign installer who's putting up three "For Sale" signs for every two that he takes down.

What's happening in Loudoun is a rapid shift in psychology—a classic sign of a market turn. The buoyant optimism that fueled speculation and expectations of ever-rising prices is now succumbing to the fear of being left standing when the music stops. Real estate, the hottest play of the century in Loudoun, is rapidly cooling.

The same signs of a slowing market can be seen in hot spots

HOUSING WATCH

KATHERINE LAMBERT

O IN THIS SECTION:

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36 End-runs around new stock-option rules

40 Is Apple's iPod stance hurting the music biz?

42 The trouble with business-friendly justices

TAKE YOUR PICK
Three "For Sale" signs go up for every two that come down

Sluggish Markets

Phoenix ▲	Miami	Tampa	Washington	Jacksonville**	Boston	Los Angeles
INCREASE* IN INVENTORY OF HOMES LISTED FOR SALE OVER THE PAST THREE MONTHS						
72.3%	47.7%	36.3%	34.1%	32.1%	28.5%	26.7%

*From Sept. 1 to Dec. 1, except Tampa, which is a two-month change (Oct. 1-Dec. 1) **Florida **Data:** HousingTracker, derived from local multiple listing services

across the country, from Boston and Miami to Phoenix, Las Vegas, and San Diego. Nationwide, a leading indicator for housing—sales that are pending but not completed—declined 3.2% in October from September, the National Association of Realtors reported on Dec. 6. Mortgage rates, while still low, have edged up almost half a percentage point from a year ago, to 6.26%, according to Freddie Mac's weekly survey.

Many other overheated areas could suffer even larger price drops than Loudoun County. Some, like Boston, lack the rapid growth in jobs to support rising prices. In Phoenix, high prices and cheap land have sparked a construction boom that's beginning to deflate the bubble. Other areas, such as Las Vegas and Florida cities like Miami, have seen rampant speculation. Such buying not only drives demand but "feeds the expectations of households that are not speculating," says David Stiff, chief economist of Fiserv CSW Inc., a housing data company. "If a significant portion of demand is speculative, that can evaporate very quickly."

FROTH SUBSIDES

SPECULATION IS SWINGING the market in Loudoun as well. Underlying demand is strong, with families flocking in for jobs and well-regarded schools. But the recent froth was churned up by investors convinced that housing supply can't keep up with demand. Easy financing fueled the buying boom: County officials say up to 40% of new mortgages this year were interest-only loans, with low payments enabling borrowers to finance higher bids.

Jim Williams, executive vice-president of the Northern Virginia Building Industry Assn., knew the "feeding frenzy" had gotten out of hand when a waiter in a restaurant he frequents confided that he had bought four houses on spec. "I'm sitting looking at him and thinking even with tips...he must be dying on the vine." Now, investors' scramble for the exits is creating problems for owners like Omar Singh, 29, owner of a trucking company in Herndon. His townhouse in Sterling has been on the market for $525,000 since October. He's hoping to hold out without cutting his asking price until April. But, he says, "I might not be able to."

That Loudoun could continue to balloon through the 2001 stock collapse, September 11, and 12 Fed rate hikes is a testament to its resilience. Located in the shadow of the Blue Ridge Mountains some 50 miles from Washington, Loudoun has accommodated tract houses and mansions alike without turning into a crowded suburban grid.

Now, the stock of houses on the market is at a four-year high. At Metropolitan Title Insurance Agency in Leesburg, closings dropped from 30 in October, 2004, to just 10 in the corresponding month in 2005.

Letty Mallery decided to put her historic four-bedroom house in quaint downtown Leesburg on the market in June for $1 million after a nearby home drew a megaprice in April. "The market was very hot," she says. But by the time she and her husband, John, had spruced up the home for sale, "things had cooled off," she said. They dropped the price to $950,000, then to $895,000. The Mallerys already have bought a smaller house near their grandchildren in nearby Berryville. Whatever price the stately 104-year-old house fetches, the coup can console themselves that they bougl it for just $76,000 in 1976 as a fixer-uppe

Loudoun homeowners who arrive later can take comfort in the area's ec nomic fundamentals. The county is pin ning high hopes on the Howard Hughe Medical Institute, which next year wi open a research facility that could attra other bioscience organizations. New ho tels and transportation services tied t nearby Dulles International Airport wi let more Loudoun residents live near the work. With 10% of the county's worker employed in construction—vs. 5.3% na tionally—local offi cials say Loudo must develop job that aren't dependen on homebuilding.

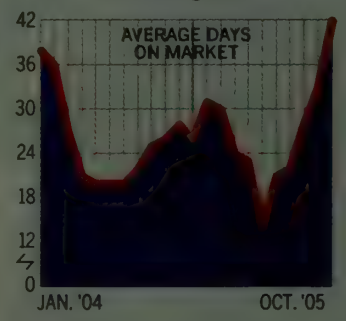
Loudoun's real es tate community in sists the market i merely reverting to more normal state "We're coming back to more of a balance," says Karen Overheu a Long & Foster Realtor with listings in Loudoun County. "You don't have to make up your mind [about buying a house] in an hour or risk losing it to someone else. It's a little insane to have it the other way."

There's another explanation, says insurance agent Joe Kelly over lunch downtown at the Leesburg Restaurant. "They ran out of stupid people." ■

–With Peter Coy in New York

SELLERS' BLUES

After a red-hot summer, Loudoun County homeowners face a worsening market



Data: Dulles Area Association of Realtors

BusinessWeek online For lists of metro areas with the greatest acceleration and greatest deceleration in housing prices, go to www.businessweek.com/extras

OURT BATTLES

THE BLACKBERRY WIDOW'S TALE

settlement of the patent fight could net 1 billion for the late Tom Campana's NTP

CATHERINE YANG

TELL CORPORATE EXECUTIVES they could soon lose their addictive BlackBerries, and they'll blow a fuse. Tell them the culprit is a tiny company whose only mission appears to be ing big companies such as BlackBerry aker Research in Motion Inc. for patent fringement, and those execs will start attering: "There oughta be a law."

But there's more to this story than eets the eye. Behind NTP Inc., the Arngton (Va.) outfit that is suing RIM, is a ll, skinny, entrepreneurial Chicago intor, Thomas J. Campana Jr., who died fore knowing how much his case ight rock the wireless orld. Late last month the ur-year-old patent dispute etween RIM and NTP moved oser to a potential courtdered shutown of RIM's ooming $1.5 illion U.S. business—or, alteratively, a settlent that could arner NTP $650 illion to $1 billon, say analysts. mong the biggest winners ould be Campana's second ife, Joletta, who stands to ecome the BlackBerry widw. She and NTP co-founder onald E. Stout together conol over 50% of the shares, ys an NTP lawyer.

Even as the stakes rise, IM is still full of fight. After hausting its appeals in the wer courts, RIM plans to turn to the U.S. Supreme Court. And, urged on by RIM, the U.S. Patent & Trademark Office is reviewing NTP's patents. In preliminary decisions, it has rejected the patents. "NTP has improperly tried to claim for itself what RIM and others independently developed," says David W. Long, Rim's lawyer at Howrey LLP.

To many, Campana and NTP are no better than corporate patent trolls. But the picture that emerges from interviews with friends and family is far more complex. Campana was an enthusiastic technologist with an effective lawyer. Although his business life had ups and downs, he may well have staked an effective claim to the concept on which RIM later built its business.

Was the patent office too generous? Did it greenlight a land grab? Those are the questions lawyers are battling over. But if Campana's patents hold up, an inventor whose career was marked by struggle stands to triumph from the grave—leaving a bonanza to his heirs and investors.

Campana's associates remember him as a relentless inventor. The University of Illinois-trained electrical engineer developed technologies ranging from wireless e-mail to a paging system to track children. It was in 1992 that Campana and his patent attorney, Stout, founded NTP to patent and license more of his inventions. "There really was a company behind the whole thing," says longtime friend Gary F. Thelen, an engineer who worked at Campana's first company, ESA Telecom Systems Inc. (ESA), which later folded. "We were using the [technologies]. It's just that we went out of business."

The son of a milkman who grew up in Chicago's working-class Marquette Park neighborhood, Campana often seemed indifferent to money. He wore battered jeans around the house while fixing neighbors' broken cars. He drank cheap Old Milwaukee beer and drove an ancient white Jaguar. But he was a passionate builder: He crafted an oak fireplace and hitched up a miniature wireless camera to his Lionel model trains. His son, Thomas Campana III, 35, who builds home theaters for a living, says he doesn't know whether he will gain any part of a RIM settlement. "That's not

Inside Story

Joletta Campana aims to vindicate her late husband's work in wireless paging

TOM CAMPANA C. 1990

1971 Thomas Campana Jr. founds ESA Telecom Services, a contract engineering company, which operated out of his basement.

MID-1980S ESA begins developing paging technologies for networking company Telefind.

1990 Campana and colleagues work with AT&T on technology to send e-mail from a pager to a laptop.

JUNE, 1992 Campana and Donald Stout, a lawyer and colleague, establish NTP to license the patents.

NOVEMBER, 2001 NTP files suit in a U.S. District Court in Virginia, claiming Research in Motion's BlackBerry infringes on NTP patents.

NOVEMBER, 2002 NTP wins in a jury trial. RIM vows to appeal.

JANUARY, 2003 U.S. Patent & Trademark Office begins a review of NTP's patents.

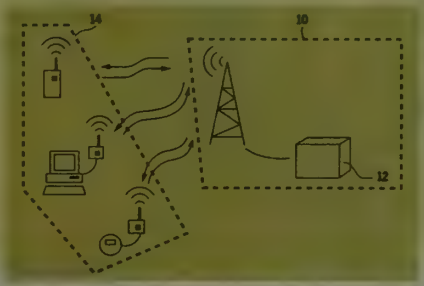
AUGUST, 2003 Court issues injunction against RIM's U.S. BlackBerry business but stays ruling pending appeal.

JUNE, 2004 Campana, 57, dies of esophageal cancer, leaving wife Joletta, two children, three stepchildren, and six grandchildren.

SPRING, 2005 RIM and NTP reach a $450 million settlement that quickly falls apart.

AUGUST, 2005 An appeals court pares back the injunction but still finds that RIM infringed on some patents.

NOVEMBER, 2005 U.S. District Court rejects RIM's motions to enforce the settlement or wait for the Patent Office review. Moves to schedule hearings on the injunction.



PAPER TRAIL From a Campana patent filing

something I think about," he says. "All I want is to see [my father's] name in good standing. It kills me to see his name dragged through the mud."

The elder Campana, whose office ceilings were stained beige from his chain-smoking, died in June, 2004, at age 57, of esophageal cancer. He left behind a wife, son, daughter, three stepchildren, and their families. Campana divorced his first wife, Maxine, in 1983 and married Joletta, his former secretary, in 1999. When Joletta took Campana go-cart riding on their first date, "I knew she was the one," says son Tom. "She brought out his fun-loving side. Before, he just worked." Joletta continued to do the bookkeeping at her husband's companies, say former colleagues.

DEMO AT COMDEX

JOLETTA, NOW 59, declined comment for this story. But she's campaigning to restore her late husband's name. On Nov. 16 she wrote a letter to her U.S. Senators. In it she recounted Campana's service as staff sergeant in the Air Force, where he worked on wireless radio. "Tom was an American success story," she wrote. "He is entitled to the same patent protection as big companies."

Campana founded ESA in 1971. A contract engineering company, its first job was to supply gear to a paging company. ESA first operated out of the basement of Campana's four-bedroom home in a close-knit, blue-collar community on Chicago's south side. Neighbors would drop by after their day jobs to work at ESA, recalls Tom.

2002 Investors bankrolled Campana's legal battle

Eventually the company grew into a 30-person outfit and helped develop paging technologies for Telefind Corp. in Coral Gables, Fla. In 1990, Campana's work in wireless e-mail attracted the attention of AT&T. Murali Narayanan, then a Bell Laboratories executive, signed up ESA to help build a system to send e-mails to the AT&T Safari laptop via a wireless paging system. AT&T showed it off that year at the giant Comdex trade show but later dropped the project. "Campana was an absolute entrepreneur—a kid at heart," says Narayanan, vice-president at Mitek tems, a Poway (Calif.) forg detection company.

In 2000, just as RIM gaining traction, NTP sent company a letter asking fo censing fees. The legal b began. NTP sued RIM in District Court in Richmo Va., in November, 2001. St bankrolled mounting expe es by bringing on more t 20 minority investors.

Not all of Campana's associates supp his legal battle. Narayanan ended up te fying on behalf of RIM. "I was surpri [Campana] got the patents," he said. "A computer guy, putting e-mail and pag together seemed obvious to me." N Campana's posthumous quest could bl Big Business and its executives' manic pendence on the BlackBerry. The inven who labored to build a wireless fut could end up throwing it into a tizzy.

–With Anne Therese Palmer in Orla Park, Ill., and Susan Zegel in New Y

ACCOUNTING

STOCK OPTIONS: OLD GAME, NEW TRICKS

Companies are finding ways to lower options costs despite stricter rules

BY JANE SASSEEN

THE ERA OF "FRE stock options is endin but some compani seem reluctant to a knowledge that bills w soon start to arrive.

During the boom yea and beyond, many companies entice employees with piles of options, which a low recipients to buy stock at a set pric And why not? If share prices rose, em ployees profited. Unlike a cash salary, op tions weren't treated as an expense an didn't dent the bottom line.

That accounting maneuver is on it way out. After losing a decade-long battl with regulators, U.S. companies will fi nally be required to deduct the cost of op tions from their earnings starting in fisca 2006, which for most means the quarte beginning in January.

Some companies are taking steps tha will moderate the hit to their earnings One gambit is tinkering with the formulas used to assign options a value which can result in lower costs. A more popular strategy has been to accelerate the vesting of options. That, too, has the effect of pumping up future profits. "It's smoke and mirrors," warns Bear Stearns & Co. analyst Christopher

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Senyek. "Options expenses could be understated for years ahead."

The amounts at stake are substantial. For the Standard & Poor's 500-stock index as a whole, expensing options will cut earnings per share by roughly 3% for fiscal 2006, according to Credit Suisse First Boston. Tech and other options-happy sectors could face much bigger income reductions.

Some companies are responding by simply issuing fewer options. Others are making less direct adjustments. That's possible, in part, because the expense attributed to options is an estimate. Using esoteric formulas, companies weigh how long an option might be held, the volatility of the stock, and other factors. Rejiggering the assumptions can lower estimates of what options will cost when recipients ultimately exercise them. Changing the assumption about volatility can have a particularly significant effect. Options for more volatile stocks are worth more because of the greater chance that recipients will exercise them when prices bounce up. Many companies have reduced their volatility estimates, apparently to whittle down options costs, according to David B. Trainer, president of investment research firm New Constructs LLC.

In 2004 alone, roughly 200 companies in the Russell 1000 cut their volatility estimates by an average of 17%, according to New Constructs. That lowered their average options expenses by 23%, saving $1.5 billion. Trainer believes that many more companies have done the same this year, although the number won't be clear until yearend financials are filed.

Some stocks are moving around less than they used to, making it appropriate to reduce volatility measures. Whatever the reason, a lot of companies are making changes. Time Warner's lowering of its expected volatility in 2004 cut its options expense by $72 million, a 28% drop, according to New Constructs. Wireless service provider Nextel Partners slashed estimated options expenses from $41 million to $33 million. A Time Warner spokeswoman says the new calculation accurately reflects the more stable range in which the company's stock now trades. Nextel Partners declined to comment.

Another tactic hundreds of companies have used is accelerated vesting. Options traditionally become effective over a period of years after they're granted and are canceled if the recipient leaves the company. By making options vest in 2005 rather than in future years, companies can bury the cost in the footnotes of their 2005 paperwork. That boosts earnings in 2006 and beyond.

The number of companies employing the practice has almost doubled since midyear, from 234 in July to 439 by late November, according to Bear Stearns. The activity has slashed $4 billion from expenses for 2006 and later years. Senyek of Bear Stearns projects that 600 companies could speed up vesting by the end of 2005, boosting future profits by over $5 billion.

One analyst warns the true costs of options may be hidden for years

Speed 'Em Up

By accelerating the vesting of stock options, companies are trimming the expenses they'll have to report for options starting in fiscal 2006. The biggest speedvesters:

COMPANY	OPTIONS EXPENSE ELIMINATED (MILLIONS)
Sun Microsystems	$400
Analog Devices	188
Flextronics	121
McKesson	117*
International Rectifier	106
Micron Technology	100
News Corp.	100
Symbol Technologies	100
Jabil Circuit	85
HCA	83

*All amounts are pretax except for McKesson

Tech companies have been the biggest speedvesters. Sun Microsystems Inc. cut future expenses by $400 million by moving up the vesting of some 45 million options early this year. In recent months, integrated-circuits maker Analog Devices slashed its future expenses by $188 million, while Micron Technology Inc. and Symbol Technologies each trimmed $100 million from future costs. Health-care companies have also gotten in on the act: Hospital giant HCA whacked $83 million out of future expenses by accelerating 19.1 million options.

Offering a common explanation, HCA Chairman and CEO Jack O. Bovender Jr. has said that the moves to protect future earnings are "in the best interest of the company and its shareh ers." Spokespeople for Symbol, and Micron n similar arguments and that acceleration please cipients. "We felt it w enhance employees' si tion and ultimately enc age them to stay," says cron's Daniel Francisco.

That reasoning is odds, however, with more familiar corpor argument that it is the future vesting options that creates an incentive for people to stay. If options vest early, s Kurt Schacht, managing director of nonprofit CFA Center for Financ Market Integrity, "you don't need stick around."

Some companies accelerating vestir including Analog and Sun, stress th most of the options in question are immediately worth anythi to employees and therefo didn't merit a big drop earnings. In late Octob Analog vested 18 million o tions that recipients cou convert to stock at prices b tween $40 and $59. At th time, Analog shares traded only $33, so there was n reason for recipients to mak a move. "The expense assoc ated with the options woul have been disproportionatel high compared to the per ceived value to employees, says Maria Tagliaferro Analog's director of investo relations. She adds that unlike most companies Analog excluded the options of officers and directors from the acceleration.

But even if options aren't valuable today, that doesn't mean they have no value in the future, when stock prices may rise, or that they are a free form of compensation. Analog shares are now trading at more than $39, so the accelerated options could soon be exercised at a profit.

Other companies' options have already paid off. The average exercise price of options that HCA speedvested was $43.96. With its shares now trading at about $52—and they have been as high as $58.40—all those options are in the money. An HCA spokesman plays down the importance of the faster vesting, saying that 65% of the options were set to vest in 14 months. ■

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MUSIC

APPLE MAY BE HOLDING BACK THE MUSIC BIZ

Critics say iTunes-only downloads and inflexible pricing are hurting song sales

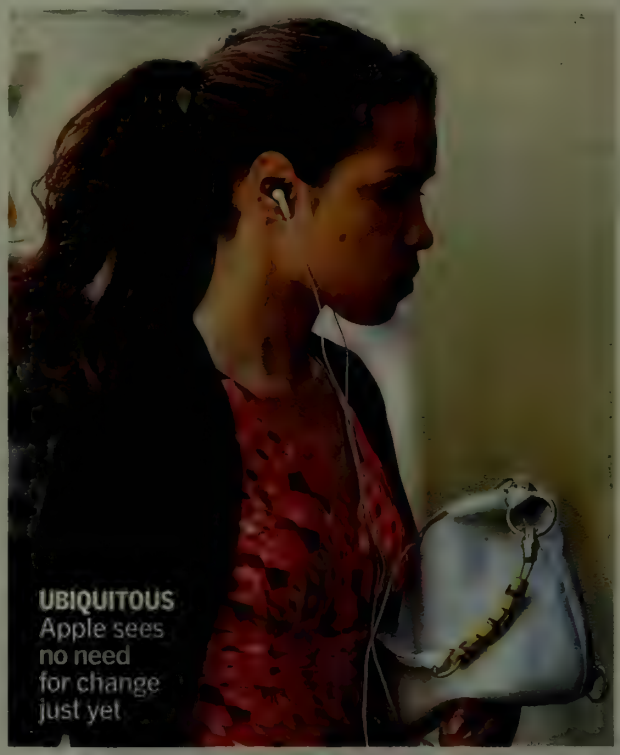
BY PETER BURROWS

ONCE AGAIN, APPLE'S iPod is expected to be the hottest gift of the holiday season. That should be great news for the recording industry, right? After all, many of the 10 million or so new iPod owners surely will rush to Apple Computer Inc.'s iTunes Music Store to load up on songs.

Not necessarily. As has been true since the start, iPod owners mostly fill up their players from their own CD collections or swipe tunes from file-sharing sites. Now legal downloads may be losing their luster. According to Nielsen SoundScan, average weekly download sales as of Nov. 27 fell 0.44% vs. the third quarter. Says independent media analyst Richard Greenfield: "We're not seeing the kind of dramatic growth we should given the surge in sales of iPods and other MP3 players."

Which brings us to a grand irony: Apple, which launched the digital music revolution, may now be holding it back. Critics say Apple's proprietary technology and its refusal to offer more ways to buy or to stray from its rigid 99¢ a song model is dampening legal sales of digital tunes. "The villain in the story is the iPod," says Chris Gorog, CEO of Napster Inc., which sells both subscriptions and downloads. "You have this device consumers love, but they're being restricted from buying anything other than downloads from Apple. People are bored with that."

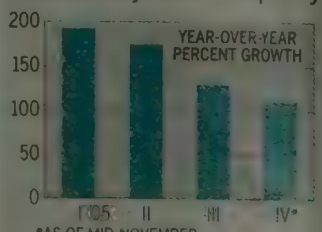
There's no need to fit Apple CEO Steven P. Jobs with a black hat just yet. A source close to the Cupertino (Calif.) company says sales of iTunes gift cards are "off the charts," so downloads should surge after Christmas. And even with the sales lull, iTunes is still the fastest-growing and most margin-rich source of sales for record labels. What's more, Jobs also may have surprises in store at the Macworld gathering in January. Some Apple watchers think he may launch an iTunes phone—one more appealing than the Rokr phone developed with Motorola Inc.—giving music download sales another jolt.



UBIQUITOUS Apple sees no need for change just yet

SLOW DANCE

The extraordinary growth in the sale of digital downloads has slowed this year. Is it temporary?



*AS OF MID-NOVEMBER
Data: Fulcrum Global Partners LLC

Still, Apple will continue to take flak. That's because an army of companies has rolled out new ways to provide music—from legal peer-to-peer sites to established players such as Real Networks Inc. and Napster that offer all-you-can-play subscriptions for a monthly fee. The thing is, very few work with the iPod. "I have half a million subscribers who would love to use an iPod with my service," says Napster's Gorog.

NO RUSH

INDUSTRY PLAYERS DROOL over what Apple could do to popularize new services. Take music subscriptions. Jobs insists people don't want to rent music and is loath to complicate his elegant iTunes store. But digitally savvy music fans are gravitating to subscriptions, which introduce them to music they otherwise might not hear. Still, subscriptions are a tough sell to mainstream customers. "The concept of a jukebox in the sky is not something most consumers intuitively get," says Dan Sheeran, a senior vice-president at Real. If Apple came in, it could change the game.

Then there's pricing. Three music companies have publicly pressured Apple to loosen up its 99¢ approach. Jobs is convinced that having a simple, acceptable price is crucial to lure music fans away from free file-sharing sites. "It might make sense to raise prices in the future," says a source close to Apple. "But now is not that time."

Music labels say they'd sell and earn more by offering an old Uriah Heep tune for 39¢ and a new Usher track for $1.29. "I'd be the kind of guy looking for older music at a lower price," says David Rosenblum, an 18-year-old political philosophy major at Harvard University and a singer who performs as Dev Avidon.

So will Jobs change his tune? Not unless he has to. Apple can barely keep up with demand for iPods, which reap as much as 25% gross margins, vs. minimal profits for each iTunes track. So right now there's no reason for the company to alter the way it sells music or make its player compatible with other services. But if download sales don't bounce back, music companies could start looking beyond Cupertino for answers. ■

—With Tom Lowry in New York and Ronald Grover in Los Angeles

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THE SUPREME COURT

BUSINESS' HIGH COURT HANDICAP

Stock holdings of justices can keep corporate cases off the docket

Business cheered when John G. Roberts Jr. took his seat as the Supreme Court's new Chief Justice. With nearly a decade's experience representing companies, he promised to get the court to weigh in on more corporate issues. But Roberts has a connection to Big Business that executives hadn't counted on: a hefty stock portfolio that has created many conflicts of interest. In his first month on the bench, the Chief Justice recused himself 16 times.

On Oct. 11, when the court said it wouldn't hear *Teva Pharmaceuticals USA Inc. v. Pfizer Inc.*, a dispute over mail-order pharmacy rules, Roberts, Justice Sandra Day O'Connor, and Justice Stephen G. Breyer didn't participate in the decision, most likely because of financial conflicts arising from their stock portfolios. A week later, when the court rejected *Merck & Co. v. Teva Pharmaceuticals USA Inc.*, Roberts, O'Connor, and Breyer again recuse On Oct. 31 the trio bowed out of *Nokia Inc. v. Naquin*, a case i volving cell phone standards that the court decided not to hear.

These episodes are raising a larger question: whether som important business cases might have a higher bar to clear t reach the court. Four justices must give consent before a cas can win a hearing. For every one that recuses, the odds of gettin a case on the docket decrease. "We'll never know if there migh have been three votes but not four" because of the recusals, say Mark I. Levy, who worked on the *Nokia* case. Other stocks owne by two or more justices include Cisco Systems, Coca-Cola, an State Street Bank. Here's each justice's recusal history:

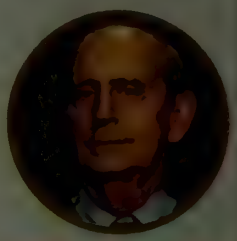
–By Lorraine Woellert, with Susann Rutledg

JOHN G. ROBERTS JR.
■ The new chief, who has already recused himself from nine business cases, has a diverse portfolio with holdings in telecom, banking, and drugs. Investments include Time Warner, Boeing, Cisco Systems, Dell, Disney, Coca-Cola, Nike, Texas Instruments, and Intel.

JOHN PAUL STEVENS
■ His 350-plus recusals do not appear to stem from financial conflicts of interest. Ever since he joined the court in 1975, Stevens has been bullish on investments in local water, sewer, and airport authorities. He reports a modest investment in a single company, BioSafe.

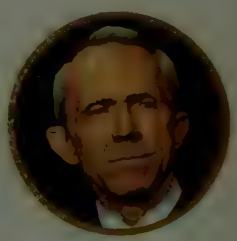
ANTONIN SCALIA
■ With the bulk of his investments in money market funds, Scalia rarely runs into financial conflicts of interest, yet he has drawn heavy criticism. In 2004 he refused to sit out a case involving Vice-President Cheney, whom he had joined on a duck-hunting jaunt.

SANDRA DAY O'CONNOR
■ O'Connor has recused herself five times this term. Because of her stock holdings in Pfizer, Eli Lilly, and Merck, she often sits out pharmaceutical cases. During her long tenure—O'Connor joined the court in 1981—she has recused herself from nearly 600 cases for a variety of reasons.



STEPHEN G. BREYER
■ In addition to sitting out Nokia case this term, Brey also has declined recently participate in petitions involving Schering-Plough Merck, BP, and Duke Energ Of his approximately 400 recusals since 1994, *BusinessWeek* estimates a majority have involved business cases.

RUTH BADER GINSBURG
■ In 1997, Ginsburg and her husband rolled their holdings into money market funds after press reports revealed that she had presided over more than 20 cases involving eight companies whose stock they both owned.



DAVID H. SOUTER
■ Souter has investments in only two companies: Chittenden, a Vermont bank, and Pinpoint Global Communications, a market strategy consulting firm. Most of his recusals came early in his time on the bench.

CLARENCE THOMAS
■ Thomas owns a share of some Savannah (Ga.) real estate and has a handful of money market funds. His recusals came early in his career. He has declined to participate in only seven cases since 2000.

ANTHONY M. KENNEDY
■ With all his assets wrapped up in annuities and cash, most of Kennedy's recusals date to his early years on the court when he was reluctant to vote in cases in which he hadn't participated from the beginning.

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960	52
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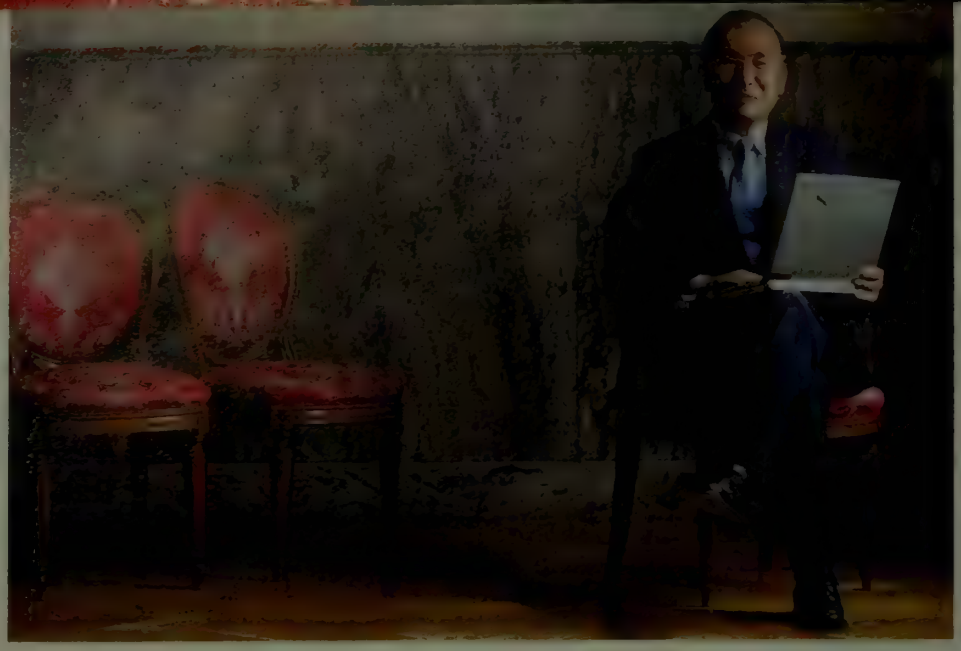
[1] Based on estimated relative webserving performance.



CEO NISHIDA
"Now is the time for us to think about our survival"

STRATEGIES

WHY TOSHIBA IS CLAMMING UP

Forget licensing—the electronics giant is keeping innovations out of rivals' hands

BY KENJI HALL AND PETER BURROWS

THERE'S AN EERIE SILENCE these days in the elevators at Toshiba Corp.'s 36-story Tokyo headquarters. A sign pasted on the door of every car reads "Quiet Please," and employees either whisper or hold their tongues as they shuttle between floors. Why the prohibition on chatter? Toshiba wants to make sure outsiders don't overhear any secrets.

It fits nicely with a campaign by new Chief Executive Atsutoshi Nishida to keep key technologies close to the vest. As a Toshiba executive for two decades, Nishida watched promising innovations become commodities as the company licensed newfangled memory chips, hard drives, and other ideas to rivals. Without a stable but low-growth business in power plants and infrastructure, Toshiba might have seen its last days. "Now is the time for us to think about our survival," Nishida says.

So six month after taking th helm at Toshiba Nishida is hopin to end the viciou cycle of tech commoditization. His pla boils down to guarding the technologie that help the conglomerate distinguish it products from rival offerings. The strate gy won't apply to everything, but it wi mean select innovations, such as next generation memory chips, hard drive and batteries that were developed in house will stay in-house. And Toshiba ha a message for anyone who dares piggy back on its patents without permission See you in court.

That thinking stands in stark contras to the way the high-tech industry oper ates today. Most companies try to per suade others to adopt their technologies then reap the benefits of their innovatio through licensing fees. While Nishida i a believer in some open standards t help new products spread, the share-the wealth model often drives margin down near zero—as hordes of low-cos manufacturers in China, Taiwan, an elsewhere jump in. Indeed, Toshiba ha been a beneficiary of this system, earnin decent royalties during the past decad from both its DVD and flash memor technologies. But those licensing deal haven't ensured profitability: The pea years for royalty payments on DVDs hav coincided with the company's leane period. So Nishida says Toshiba will no do better by keeping its smartest inno vations to itself and charging more fo its own products that include them.

A few years ago, Toshiba was too pre-occupied with getting its house in order even to consider such a strategy. It has missed its profit targets in four of the past five years, spurring layoffs of 20,000 employees—11% of its workforce. Today, though, brisk sales of semiconductors and electronics have Goldman Sachs Japan Ltd. forecasting profits for Toshiba

Hands Off

Toshiba wants to keep key technologies in-house rather than sharing them with outsiders, as it has traditionally done. Some examples:

FUEL CELLS

Refillable cells running on liquid methanol for mobile phones, laptops, and more; to reach market by 2007.

Challenges:
They're still too big, and regulations today prohibit methanol on planes.

FAST BATTERIES

A battery for hybrid cars that fully recharges in about a minute; to reach the market in 2006.

Challenges:
The batteries will be more expensive than current models, at least early on.

FLAT-SCREEN TVS

New technology offers clearer images and consumes less power than current flat TVs; to reach market in 2006.

Challenges:
It may be tough to make them as cheaply as LCDs and plasma screens.

FLASH MEMORY

Smaller, less power-hungry chips for cell phones, MP3 players, and other gizmos. To reach market next year.

Challenges:
Rivals Samsung, Intel, and others will be tough to beat on price.

$762 million—66% better than the mpany's estimate—on sales of $51 lion. Next year, Goldman expects the mpany's earnings to jump an addi-nal 30%.

A lot of Toshiba's innovations will be gely invisible to consumers. Its re-arch engineers, for instance, are rking on smaller, denser, and less wer-hungry flash memory chips that e expected to hit the market next year. the past, Toshiba would have sold at technology to other chipmakers. t this time, says Nishida, Toshiba will ake the new chips by itself—although ey'll probably end up in devices made other companies. Similarly, Nishida ys Toshiba will be the sole manufac-rer of hard drives with a technology at can boost capacity by up to a third, d of a new type of battery for gas-elec-ic hybrid cars that can be recharged in st a minute or so.

EGAL ACTION

THER TOSHIBA innovations will be nmediately recognizable. In 2007 the mpany expects to market Toshiba-anded cell phones, music players, d other gadgets powered by refillable el cells that convert liquid methanol to electricity. Also in 2007—just in me for the Beijing Olympics—Toshiba pes to open a $1.8 billion factory aking high-definition flat-screen TVs sing a technology it developed in con-nction with Canon Inc. that uses less ower and delivers a sharper picture.

Toshiba is backing its strategy with ction. On Sept. 29 it took a long-mmering dispute with Korea's Hynix emiconductor Inc. to the U.S. nternational Trade Commission in Vashington. Toshiba says Hynix owes hefty royalty payments for flash nemory chips, which Toshiba invent-d—but Hynix says Toshiba actually wes it money. One big reason for the tepped-up action: The chips are the emiconductor industry's fastest-rowing sector. Toshiba is laying out 1.9 billion this year to triple flash out-ut by next March, and it doesn't want thers to benefit from its research. Toshiba will increasingly sue rivals in atent rights cases that can't be settled vith negotiations," says Taisuke Kato, vho heads Toshiba's intellectual-prop-rty division.

It's a hardball strategy for a company hat has been lax for years about its nost valuable assets. And it could well e effective even when secrets are icked up in elevators. ■

RIVALS

AMD'S ASIAN THRUST

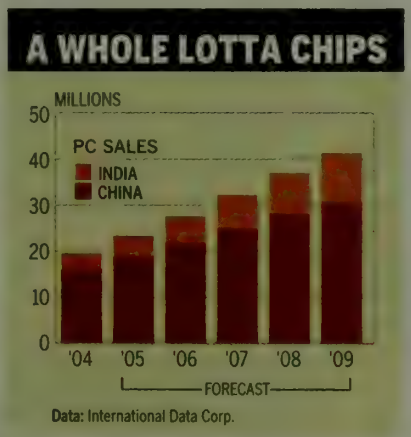
It's challenging Intel's hold on China and India

BY MANJEET KRIPALANI AND BRUCE EINHORN

IT'S ONE OF THE WORLD'S MOST lopsided two-company battles. Globally, Intel Corp.'s chips power 85% of PCs and servers, while those of Advanced Micro Devices Inc. are in just 15%. But AMD is seizing the opportunity in the two biggest developing markets, India and China. Intel, meanwhile, senses the heat and is pushing back against its scrappy rival. "The future growth for Intel will be driven by emerging markets, and China and India are key," says Amar Babu, Intel's South Asia sales and marketing director.

LENOVO'S LUSTER

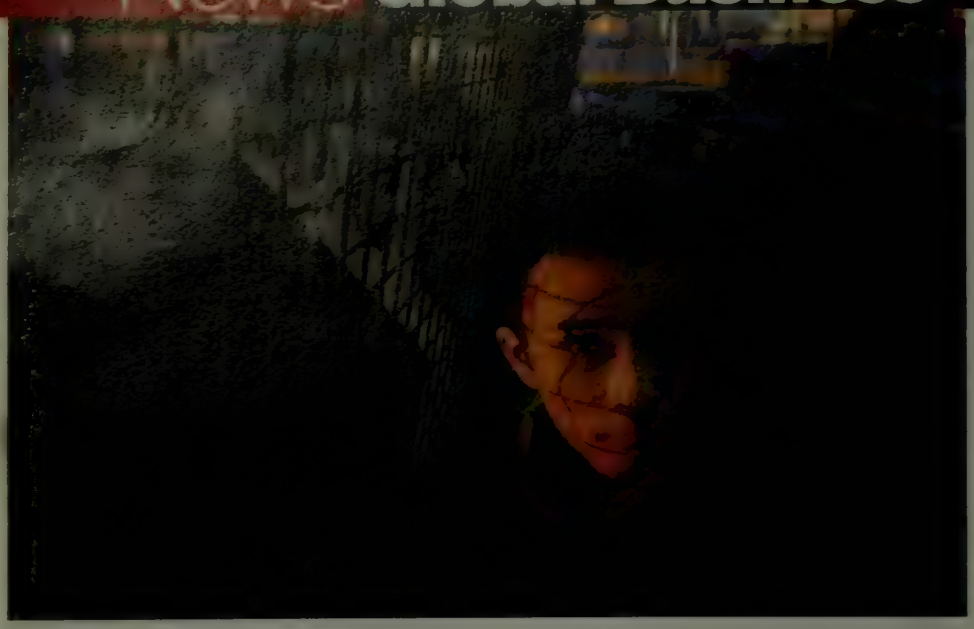
BOTH COMPANIES are doing their best to woo Asia's giants. Hector Ruiz, chief executive of AMD, arrived in India on Nov. 30 and said AMD would join a consortium to build India's first semiconductor plant. As he was leaving, Intel Chairman Craig R. Barrett touched down to announce a $1 billion investment for chip research in Bangalore and venture-capital investment in Indian startups. And during an October trip to China, Ruiz said AMD would share technology with Beijing, while Barrett on Dec. 6 opened a $200 million assembly and testing facility in the western Chinese city of Chengdu.



AMD has been emboldened by recent gains in China. Last year, Lenovo Group Ltd., the leader in the Chinese PC market, agreed to use AMD chips in most of the desktops it sells on the mainland. That has helped the underdog chipmaker more than double its market share, to 19%, in the past year. "Winning Lenovo was a very key milestone for AMD China," says Rose Wang, AMD's director for corporate marketing in China. In India, AMD has boosted its share from nothing to 13% by establishing strong relationships with local PC makers.

Now AMD is playing to Indian pride. In June, Technology Minister Dayanidhi Maran tried to convince Intel to open a chip-testing facility in India. But Barrett was noncommittal, infuriating Maran. AMD then stepped in with a pledge to supply technology for a chip factory. In exchange, Maran promised that ministries and organizations such as the country's railways and schools—which together account for more than a quarter of all PC purchases—must consider both AMD- and Intel-powered computers. In the past, government contracts had specified Intel processors as a way of keeping fly-by-night manufacturers out of state institutions.

To be sure, AMD is far from winning the microprocessor wars in either country. Intel has a commanding market presence in both, with far better distribution, more sales execs, and thousands of researchers. And next year, Intel will unveil a low-cost PC for use in the rural multimedia kiosks springing up across India. If successful, the product could find its way to China as well. Nonetheless, if AMD can keep making strides in Asia's emerging giants, the global microprocessor competition may become a bit less lopsided. ■



AUTEUR Chan's *The French Democracy* (below) is an instant hit

FRANCE

YOUNG SPIELBERGS BY THE THOUSANDS

Machinima—making movies using video game software—starts to explode

BY CAROL MATLACK

ALEX CHAN SIMPLY wanted to make a political statement, countering what he deemed inaccurate coverage of the riots in French suburbs. Instead, the industrial designer created an emblem for a hot new form of entertainment. Working on his laptop with software from a $70 video game—a technique called machinima—Chan made a rudimentary but powerful 12-minute animated film about racism, *The French Democracy,* that is winning applause worldwide. "What I love is how neatly it blends the culture of games with the aesthetics of film," says Clive Thompson, a journalist in New York who has written about machinima and runs a well-known blog on technology and culture.

Since it emerged in the late 1990s, machinima has been the playground of mainly hard-core gamers who cobble together characters and sequences from favorite games, adding voice-overs laced with references that only fellow gamers can grasp. But with more user-friendly software tools on the market, novices can create their own narratives. That will democratize the movie business, machinima enthusiasts say. Anyone with a computer and off-the-shelf game software can now make and distribute animated movies over the Internet. "This is to the movies what blogs are to the written media," says Paul Marino, executive director of the Academy of Machinima Arts & Sciences, a New York nonprofit.

Many entertainment executives see machinima as an opportunity rather than a threat. One is Eva Shapiro, general manager of Independent Film Channel, a unit of Cablevision Systems Corp. that reaches 36 million U.S. homes. IFC has sponsored a machinima film festival and commissioned six films from animation companies such as the ILL Clan and RoosterTeeth Productions. The films are cheap and appeal to IFC's tech-savvy viewers, Shapiro says. "This is grassroots moviemaking at its best."

1 MILLION HITS

CHAN PRODUCED HIS film using a video game called The Movies, in which players make their own films. He then posted the film on a site hosted by the game's developer, Lionhead Studios Ltd. of Surrey, England. The site is hot: Within three weeks of the game's November release, users posted more than 15,000 films. New ones are being added at a rate of one per minute. *The French Democracy* helped the site hit 1 million unique viewers in the past month.

No one is more astonished than Chan. The 27-year-old from the Paris suburb of La Courneuve was upset by news reports suggesting the violence was linked to Islamic fundamentalism. The film weaves together the experiences of three dark-skinned characters, all French citizens, to back Chan's contention that racism was a key reason for the riots. "I wanted to get people to understand why this happened," he says. It's not a polished work of art: The street scenery provided by The Movies is in Manhattan, so Chan's French characters act against a backdrop that includes the Empire State Building. Still, the film packs an emotional wallop.

The buzz over the film could help Hollywood and machinima move closer together. Directors George Lucas and Peter Jackson already have tried the technique for special effects. Who knows: The maker of the next blockbuster may be hunched over a computer right now, ignoring Mom's calls to dinner. ■

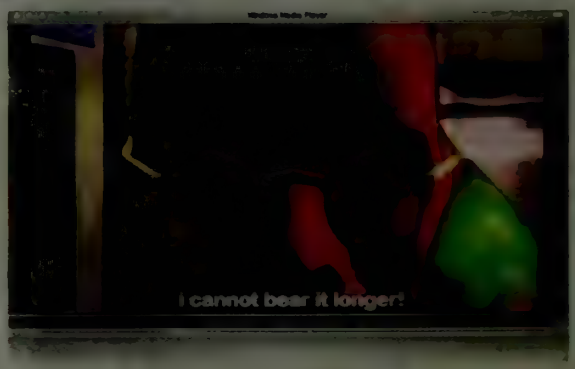
–With Ronald Grover in Los Angeles

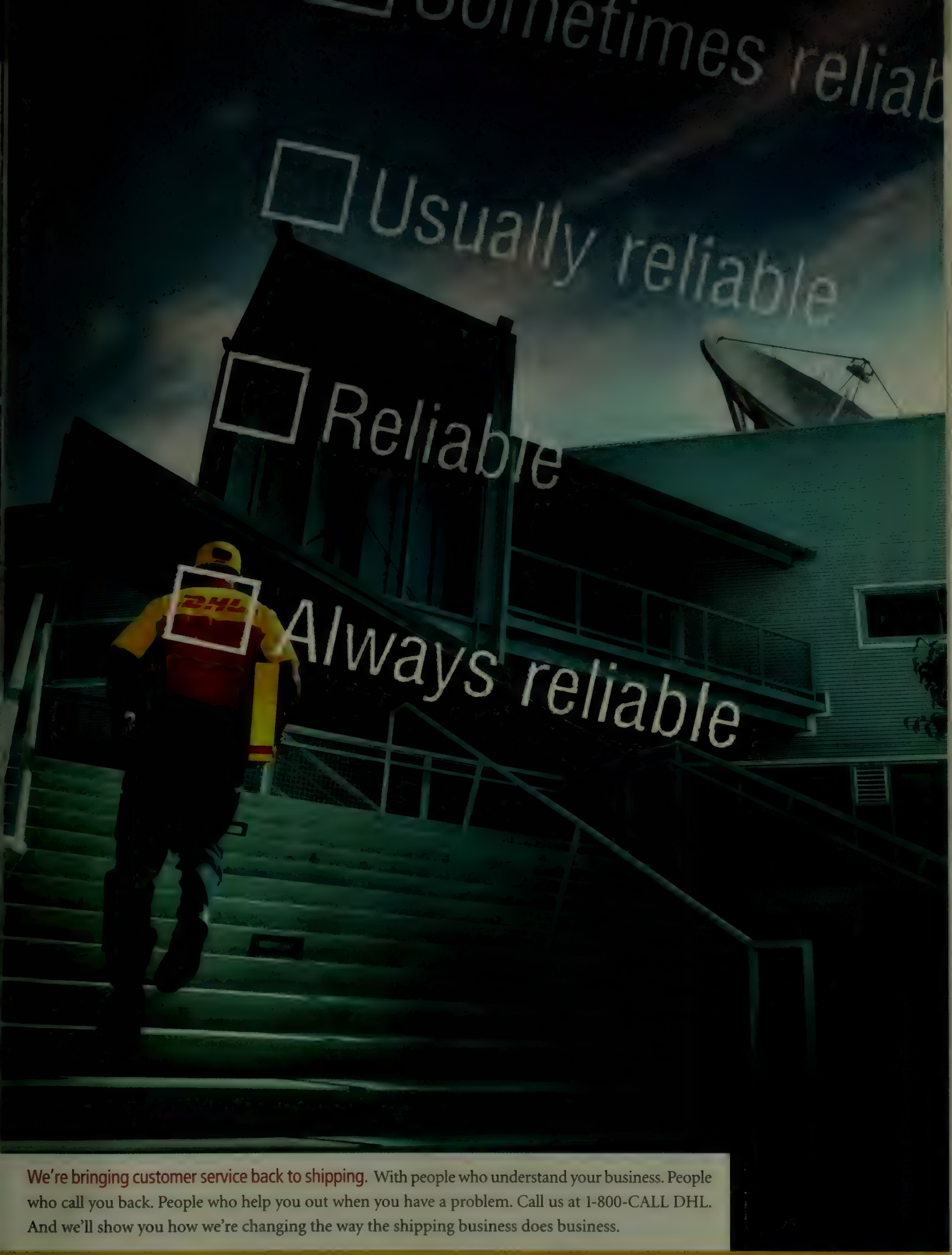
THE STAT

New Machinima films are posted on British site Lionhead.com at a rate of

1

PER MINUTE





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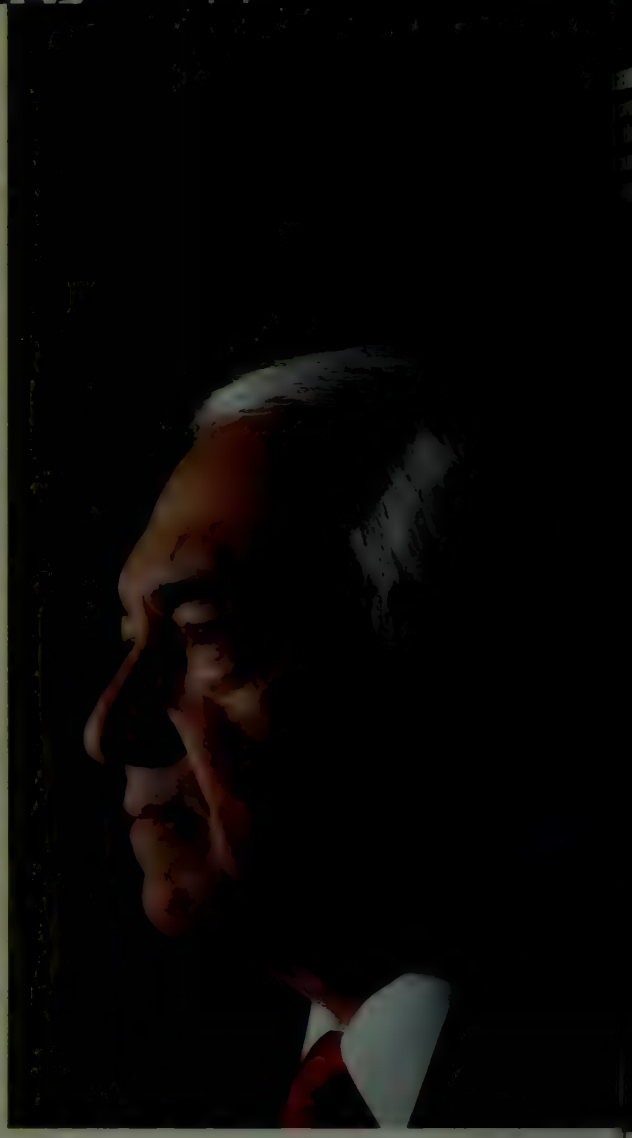
With $15 billion in deals to disburse, it's changing the tech outsourcing biz



BY STEVE HAMM

IN A GENERAL MOTORS CORP. wracked by crisis, Ralph J. Szygenda plays a peculiar role: sugar daddy. While the rest of the corporation grapples with layoffs, plant closings, and the risk of benefits evaporating into the Michigan air, Szygenda, the chief information officer, holds $15 billion of mouthwatering contracts to disburse. It's the world's biggest-ever tech outsourcing package. And for a handful of high-tech companies, including EDS, Hewlett-Packard, CapGemini, and IBM, the beleaguered auto maker represents El Dorado. To scoop up this treasure, senior tech executives are beating a path to Szygenda's perch on the 34th floor of the Renaissance Center in Detroit. Ann M. Livermore, executive vice-president at Hewlett-Packard Co., says: "I'm sure Ralph will want to look in the whites of my eyes and make sure we're fully committed."

Szygenda's five-year contracts, due to be awarded within weeks, are intended to modernize GM's global operations—but they promise scant short-term relief. For tech companies, however, winning or losing the Szygenda sweepstakes could be crucial. An eager IBM has assigned to the case a team of 500 people worldwide. Electronic Data Systems Corp., historically the biggest outsourcer for GM, has the most to lose. It carried out $2 billion in business with GM last year. That amounted to two-thirds of GM's tech budget and 10% of EDS' revenue. "We'll be very disappointed if we don't remain the leading player, but we're optimistic," says CEO Michael H. Jordan of EDS.

The 57-year-old Szygenda, a nine-year veteran at GM, has a long history in tech outsourcing. He has suffered his share of glitches and snafus. Now he's attempting to use his massive leverage to change the way business is done. The result could well reverberate far beyond GM—and shake up the $300 billion tech outsourcing industry. Under Szygenda's scheme, the company retains more control, breaks big contracts into smaller pieces, and imposes standard ways of doing things that mean one supplier can quickly pick up where another leaves off. "This is revolutionary," says George F. Colony, president of market researcher Forrester Research Inc. "If it works for both sides, in a couple of years you'll see a lot of other companies doing it."

While outsourcing is a megatrend in computing, it has hit a rough patch recently. Corporations have grown frustrated with their loss of control and the inflexibility of contracts. At the same time tech companies doing the work struggle to make money on the contracts. As a result, according to market researcher Gartner Inc., nearly half of all outsourcing engagements are rated as disappointments. Szygenda's solution is designed to make outsourcing less expensive and simpler—and to foster innovation.

Szygenda says he came to the conclusion three years ago that the outsourcing status quo was out of kilter. GM had a Web site called Hermes, to sell cars in Brazil. The site—run by EDS, IBM, and a handful of others—kept crashing. And when Szygenda got on a conference call with his tech suppliers, "there was a lot of finger-pointing, and nobody would fess

PLAYBOOK: BEST-PRACTICE IDEAS

The Pioneer's New Playbook

RETAIN CONTROL
By managing outsourced projects, GM can react more quickly if it needs to change direction.

KEEP IT SHORT
Rather than 7- or 10-year contracts, GM is sticking to 5. This keeps service providers on their toes.

PARCEL IT OUT
GM hands out contracts to several suppliers so it can play one against another in negotiations.

STANDARDIZE
By imposing a single set of operating rules, GM can switch providers more easily.

DONNA TERER

ENDA GM's projects add the largest ourcing age ever

up to the problem," he recalls. "I realized this wasn't going to work. And I saw it wasn't just a GM problem. It was an industry problem."

So Szygenda set out to rethink how technology should be managed. With his leverage as the world's largest tech outsourcer, he had the muscle to turn these thoughts into action. Last year, he invited a dozen major tech companies to help him design the rules that all would have to follow. The result: No matter which suppliers do a particular job, they do it GM's way.

At the same time, Szygenda decided that GM needed to maintain more control of the process. Rather than relying on service companies to make the strategic decisions about his technology, he as-gns his own employees to manage it. nd rather than the 7- or 10-year con-acts that have been typical in the in-ustry, GM is sticking to five-year con-acts. That way, the outsourcers are nder the gun to keep GM satisfied.

NE FELL SWOOP

VEN THE BIDDING process is a radical eparture from yesteryear, when GM and ther companies typically requested pro-osals from a handful of tech companies, innowed the list down to two, and then icked one. Not anymore. This fall, GM ummoned a half-dozen suppliers to De-oit for three rounds of intense weeklong egotiations. The goal was to get every-ning done in one fell swoop, rather than ing-ponging through months of negoti-tions. GM negotiators would meet with eams from each bidder on each piece of e project every day for five days. Maryann Goebel, chief information offi-er at General Motors North America, re-orts that a typical workday would last om 6:30 a.m. to 10:30 p.m. "It was ex-austing and exhilarating," she says.

For the tech outfits, those sessions were like barefoot marathons. IBM set up a war room, where staffers would gather any time of day or night to resolve issues that had been raised in negotiations. The goal was to be able to come up with answers fast, so talks with GM could go on uninterrupted. The pace was grueling, but the rivals kept their sense of humor. One bidder jokingly inserted in the offer a line item for "pain and suffering."

This is just as nerve-racking for Szygenda as it is for the bidders. Beyond the current financial crisis, GM's long-term viability hinges on a flexible manufacturing network, deployed globally, that can turn production in a flash. The company is shifting its focus from regional to global. That means that if buyers in the Midwest suddenly fall for Saabs, GM will be flexible enough to produce them in Ohio—not just Sweden. Szygenda and his suppliers are building the technology that will make this possible.

Szygenda is a confident man, with many victories under his belt during 34 years in the tech industry. His voice carries weight. But he's also humble in the face of huge challenges. "Pray for me," he says. You can bet GM's employees, suppliers, and dealers are doing just that. ■

Turnarounds

Can This Really Be Hewlett-Packard?

It's running on all cylinders thanks to shrewd refocusing and cost-cutting under CEO Hurd

BY PETER BURROWS

FOR YEARS, HEWLETT-Packard Co. seemed locked into the role of computerdom's least likely to succeed. Caught in a no-man's land between hyperefficient Dell Inc. and technology powerhouse IBM, HP became known mostly for epic earnings misses, a controversial merger with Compaq Computer Corp., and acrimony among employees and investors during the stormy reign of Chief Executive Carleton S. Fiorina.

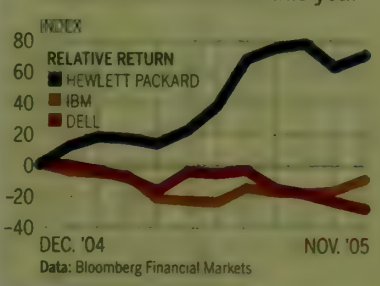
Funny how a 40% rise in the stock price can change the mood. That's how much HP's stock has risen since April, when Mark V. Hurd moved from NCR Corp. to take control of the Silicon Valley giant. Since then, HP has grabbed share in key markets such as PCS and storage gear, and shown crisp execution reminiscent of its glory days. In its most recent quarter, ended Oct. 31, HP beat Wall Street's expectations by 12%.

The most hopeful news for investors may be that all of the company's businesses are now profitable, after years in which its $25 billion printer business covered losses at the rest of the $87 billion company. The surprise tale of the ticker: HP shares no longer trade at a big discount to IBM and Dell, whose shares have fallen 1% and 17%, respectively, since Hurd took charge.

How did Hurd get off to such a fast start? Cost-cutting, in particular a 10% reduction of the workforce in August, has

A ONETIME LAGGARD RISES

HP shares have outpaced those of Dell and IBM this year



Data: Bloomberg Financial Markets

helped. But Hurd has brought operational focus to initiatives begun by the marketing-oriented Fiorina. For example, he arrived just in time to reap the benefits of vastly improved product lines in laptop PCs and storage gear—two critical growth segments where the company has been particularly weak. Having largely integrated nearly a dozen acquisitions made over the past 18 months, HP's $1 billion software business turned a profit last quarter after years in the red.

CHIP CHALLENGES

INSIDERS ARE NOW waiting for Hurd to lay out his growth plans at a Dec. 13 analysts' meeting. One priority will be corporate computing. While it is a leading supplier of bare-bones servers, HP has been trying for years to increase sales of higher-margin software and services. Now, it will focus on helping companies simplify their sprawling tech operations with the use of management software—even if it means selling less hardware in the short term as customers boost utilization of machines they already own. Another key initiative: selling more industrial-strength imaging gear to take share from large copiers and commercial-printing presses.

So much for basic repairs. Now HP can focus on growth

Plenty of challenges remain. HP has phased out its high-end server chip in favor of Intel's troubled Itanium family of processors. Rivals point to repeated delays and lowered performance specs on the Intel chips. "I think HP is in trouble," says Karl Freund, vice-president of IBM's high-end server business. "Customers are evaluating their options." And few analysts think HP can find new printer markets fast enough to compensate for falling demand and pricing on consumer models.

Still, it's a far cry from the dour mood of a year ago. Back then, investors, rivals, and even many insiders assumed HP was a sitting duck, too beset with internal problems to fight off nimbler rivals. Not anymore. "Mark has been busy getting the engine tuned," says director George A. "Jay" Keyworth II. "Now, we're turning our attention to growth again." ■

Big Pharma's Favorite Gadfly

Steven Nissen's industry ties don't stop him from questioning drugs like Celebrex

BY AMY BARRETT

AT A TIME WHEN DRUGmakers are under fire for selling risky products, Dr. Steven E. Nissen occupies a unique position. A cardiologist at the Cleveland Clinic Foundation, Nissen is both a gadfly and a leader of clinical trials determining the effectiveness and safety of new drugs.

The story of how Nissen came to play this critical yet controversial role goes back to 2001, when he began serving on a Food & Drug Administration panel reviewing new drug applications. He initially believed that the review process was sound. But four years working on the inside turned him into a radical. "Companies don't always do the right thing," he declares, "and the FDA misses some signals."

In the course of his conversion, Nissen has lobbed some powerful grenades. He and his boss, Dr. Eric J. Topol, were among the first to raise alarms about Cox-2 inhibitors—a class of painkillers that includes Merck's Vioxx and Pfizer's Celebrex. The former has been pulled from the market amid evidence that it may trigger heart attacks. And Pfizer Inc. says it is now planning a long-term study on the cardiovascular profile of Celebrex—after constant prodding from Nissen and others. Nissen was also an early critic of Johnson & Johnson's controversial heart failure drug, Natrecor. And he published a paper in late October warning of potential safety problems with a diabetes drug from Bristol-Myers Squibb Co. and Merck & Co.

Nissen isn't all rebel, however. The 57-year-old physician

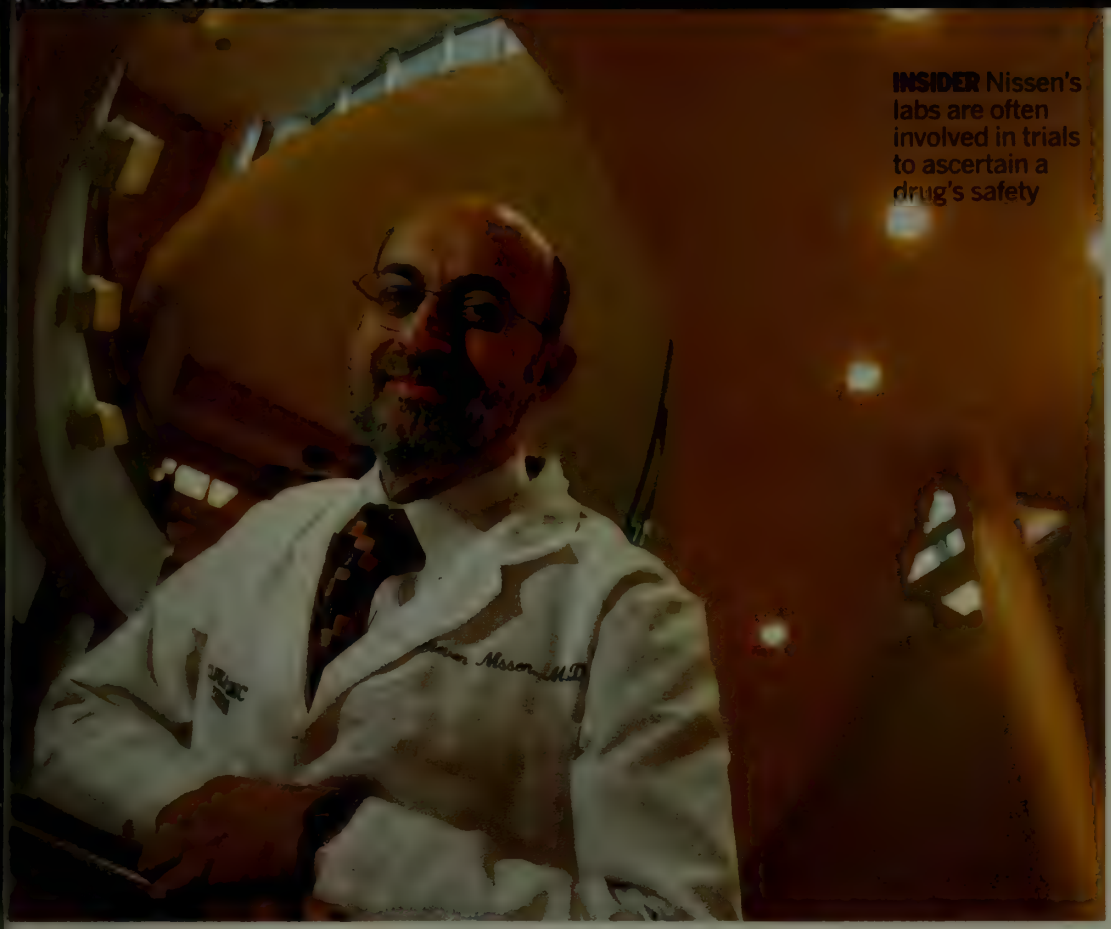
Med Maverick

Cardiologist Nissen has clashed repeatedly with the pharmaceutical industry:

COX-2 DRUGS In 2001, Nissen and his boss, Dr. Eric J. Topol, published a paper warning of possible cardiovascular problems with Cox-2 painkillers Vioxx and Celebrex. Merck has since withdrawn Vioxx from the market. Pfizer is planning to do a long term study to assess the risks of its drug, Celebrex.

NATRECOR In 2001, while serving on a Food & Drug Administration panel reviewing Natrecor, a heart failure drug, Nissen argued it should carry a serious warning about possible safety problems. Questions about safety have mounted since then. Johnson & Johnson's Scios unit, which sells the drug, is doing further studies.

PARGLUVA In October of this year, Nissen co-authored a paper highlighting the possible cardiovascular problems associated with Pargluva, a diabetes drug under development by Bristol-Myers Squibb and Merck. Bristol says that the FDA may require additional studies, and that the drug could be killed.



INSIDER Nissen's labs are often involved in trials to ascertain a drug's safety

as deep ties to several drugmakers, in-uding those whose products he has ublicly criticized. In fact, Nissen's de-actors point out that he often urges ompanies to do trials to answer safety uestions—trials that his institution ould clearly be a candidate to lead. And e helped device companies create and st an imaging technology, intravascular ltrasound (IVUS), that drugmakers use study cardiovascular therapies. Thanks the network he has built of 300 hospi-als that will participate in his IVUS stud-s, Nissen has a big head start in apply-ng that technology to heart drug studies. mong the cardiovascular drug trials he leading is a massive study of the Pfizer rug torcetrapib, which raises "good" holesterol. Nissen promoted the ultra-ound technology aggressively to Pfizer xecutives in the late 1990s. Now Pfizer is oping Nissen's studies will show that orcetrapib is actually causing a reduction n plaque that clogs heart vessels.

Drug companies may get agitated vhen Nissen raises a stir about safety, but here's not much they can do. "Who else s going to do the IVUS trials for them?" Nissen asks. "I have some advantages, nd I use [them] when I can."

Nissen knows that consulting for drug ompanies could compromise his credibil-ty. To insulate himself from potential con-licts of interest, he stopped accepting fees rom the industry several years ago. Instead, he tells companies to make donations to the American College of Cardiology and other charities.

Meanwhile, his critiques continue to draw attention. In early September an FDA advisory panel recommended approval of Bristol's diabetes drug, Pargluva—a potential blockbuster. But Nissen and a colleague did an analysis based on the limited data that were available on the FDA Web site and in late October, they dropped a bomb: Writing in the *Journal of the American Medical Association (JAMA)*, they showed that the drug might be linked to a high rate of heart attack, stroke, and death. By then, the FDA was also requesting more data on the drug's cardiovascular safety. Bristol now confronts a tough decision: run a new, expensive trial or give up on the drug, which it still believes to be effective.

He was among the first to raise the alarm about Cox-2 inhibitors

LIMITED ACCESS

THE FDA SAYS NISSEN'S paper didn't influence its decision-making. Dr. Brian L. Strom, a professor at the University of Pennsylvania School of Medicine who has consulted for Bristol on Pargluva, agrees that Nissen's paper wasn't significant. Strom says the FDA was well aware of cardiovascular safety questions, and he argues that Nissen's analysis, based on limited access to data on the drug, contributed little to the debate. "What does an analysis of incomplete data add to that?" he asks. "And why would you publish it in *JAMA* except [to garner] press attention?"

Nissen says he takes no pleasure in clashing with the industry and only wrote the Pargluva paper because he thought no one was going to speak up about a possible "patient catastrophe."

Medicine wasn't initially in Nissen's stars. As the son of a gynecologist growing up in Southern California, he initially bucked his father's insistence that he become a doctor. Nissen took eight years to get his undergraduate degree at the University of Michigan, a period in which he actively protested the Vietnam War.

Later, Nissen grew increasingly ambitious. As a young cardiologist at the University of Kentucky Chandler Medical Center, he started a medical helicopter service to fetch very sick heart attack patients from rural areas, making hundreds of rides on the aircraft. In the early days of developing the IVUS technology in Kentucky, Nissen and colleagues would wait until late at night, then sneak lab dogs into the hospital rooms used to perform human cardiology procedures. They would work until 1 or 2 a.m. testing the new equipment on the dogs, then furiously clean up any errant canine hair so hospital officials would remain in the dark. "He's a swashbuckler," says Dr. Anthony N. DeMaria, a top cardiologist at the University of California at San Diego School of Medicine and Nissen's former boss in Kentucky.

Even though Nissen no longer accepts consulting fees, he benefits indirectly from the clinical trials that flow through his lab, gaining influence and prestige. But that never deters him from taking a critical stance, he says. After all, he was raising questions about Cox-2 drugs even as he was doing work for Pfizer, one of the biggest Cox-2 promoters. As Nissen puts it: "I'm an insider and an outsider at the same time." ■

–With John Carey in Washington

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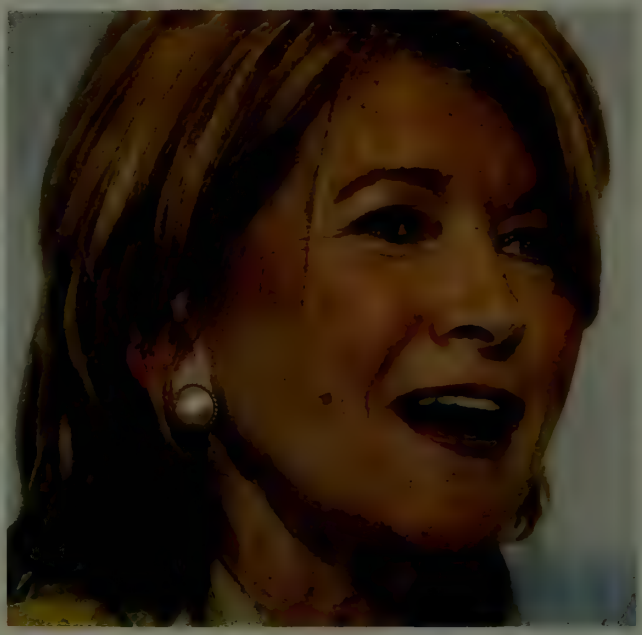
'I Consider Myself The Visionary Still'

Martha Stewart on her TV shows, her return to work, and, yes, her time in jail

MARTHA STEWART'S celebrity somewhat obscures her substance. In her business, as well as in her cooking, her gardening, and her entertaining, she is truly a perfectionist. And at heart, she is an entrepreneur. In big media companies these days, everyone talks about creating multichannel operations; Stewart has been doing it for years. Stewart personally, of course, is a considerable newsmaker, and recently she has been in the news for her trial, the incarceration, the travails of her home confinement, and her resurgence as a business leader. She spoke with *BusinessWeek* Editor-in-Chief Stephen J. Adler in Manhattan in early December as part of the Captains of Industry series held at the 92nd Street Y in Manhattan. Following are edited excerpts from their conversation:



A big part of your reintroduction to the public has been two TV shows that launched this year: *The Apprentice: Martha Stewart* and *Martha*. Which has been more satisfying to you?

It's unusual for me to take a job like *The Apprentice*, and it was just a job. I got paid a fee. I have no participation in the show. Generally, we're the originators. But I did it because I knew it would be a jump-start, and it would get attention.

> "[Re *The Apprentice* contestants:] I can't believe people behave like that. They're exhibitionists and opportunists, those kids"
>
> —*Martha Stewart, Founder, Martha Stewart Living OmniMedia*

You're getting close to the conclusion.

Yeah, we're getting close to which of those inappropriate contestants we are actually going to have to hire. I can't believe people behave like that. They're exhibitionists and opportunists, those kids. I did not choose them either, by the way. I just want you to know I had nothing to do really with the choice of the contestants. That's part of reality television.

How is your relationship with Donald Trump?

I would not say we were close friends but we are friendly to one another. I always like people who are themselves. Donald is himself. You see it on TV. He's the same person on TV that you know in person—the same guy. He's not an actor. He's not a fake. And his hair really is horrible. When I get close to him, I just want to [get] the scissors. But he's a nice guy, and his wife is really nice. All his other wives are really nice, too. He didn't know about me coming on [with a new version of] *The Apprentice*. This was as big a surprise to him as it was to me, that he wasn't leaving.

Your title [at Martha Stewart Living OmniMedia] is now founder, and Susan Lyne is CEO. Would you like to be CEO again?

I'm very happy with my current status. I am doing the same work I've always done. I'm working hard to develop the businesses with Susan. [She] is a very competent CEO.... I consider myself the visionary still. I have lots of visions, and I want to help develop those visions into real, substantial businesses.

Would you consider your daughter, Alexis, a potential successor to you at the helm of the company?

Alexis is very different from me. She's entrepreneurial. She's done a lot of things on her own. But I don't know if I want her to be my successor. I wouldn't wish this job on anybody but [one] who loves it so much. It's hard work.

You said that prison was "by far the least bad part of the last three years." Can you explain what you mean by that?

I was locked in a pleasant environment for five months.... And I used my time well.... Before that, I was exposed on all sides to

LEGG MASON

December 2005

To Our Clients and Shareholders Worldwide,

Today represents a major milestone in the proud, over a century history of Legg Mason. With the successful acquisition of Citigroup's worldwide asset management business, Legg Mason has transformed itself from a well-regarded money management and regional securities firm into a global asset manager with more than $800 billion in assets under management. We undertook this important step to enable us to concentrate all of our resources on what we believe we do best: *managing your money*.

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Raymond A. "Chip" Mason
Chairman, President and Chief Executive Officer

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the press. I remember going into a Kmart just to do my regular run around to see how the product looked, and one woman was buying a sheet and her husband said, "You can't buy that. She just was convicted." And he threw it back on the shelf. I went over to him and I said, "Oh, hi, I'm Martha." I said, "If you really look at the product, you will see that your wife should buy it because it's really good. It doesn't matter that I was convicted because the product is the same." They bought it.

In retrospect, did the company overreact during that period and dissociate you from the brand more than it should have ?

The company was in a terrible position. Advertisers didn't know whether to advertise or not. The Japanese didn't know whether to cancel the magazine or not. It was just the most horrible position for any management to be in. There was no certainty.

You are an opinion leader in a lot of areas, but I haven't heard a lot about your political views. Who should be President in 2008?

If there is a woman running, I will be voting for the woman. I think [Hillary Clinton] would do a wonderful job. I think it would be very difficult and a big struggle for her, but I think she of all women out there would do a very good job. And maybe it's time for a woman President.

I read something about you launching a new magazine called *Blueprint* aimed at people in their 30s who are interested in first homes.

We haven't formally announced it. We have been working on a thirtysomething magazine that will help young people. And they're very needy, actually. We have found that many young people need good practical advice about how to design not only their homes but everything around them—their lives. But when I say "design their lives," we don't want to tell them how to. We want to show them ways to. I think that that would be a very successful magazine.

Is there any task around the home that you are really afraid of?

You know, I'm not a good carpenter. I like plumbing. I like electrical [work]. But not carpentry. ■

BusinessWeek weekend

For a video of this interview go to www.businessweek.com/extras

Business Wants A Piece of Charlie

By reviving the Irish, Notre Dame coach Weis has become a hot commodity

BY MARK HYMAN

ON JAN. 2 A NOTRE Dame tradition will be born again. After a string of underachieving teams and coaching changes that left a national base of rabid fans little to rah-rah about, the Irish will return to the college football limelight. Southern Cal and Texas may be meeting in the Rose Bowl for the national championship, but Notre Dame has a lucrative date against Ohio State in the Tostitos Fiesta Bowl, one of this year's elite Bowl Championship Series games.

A few days later, a lesser-known Notre Dame tradition will play out, perhaps over coffee and bagels: that of coaches being blitzed with offers. Charlie Weis—the innovative, weight-challenged rookie who rose to big-program savior by an unlikely route—and his agent, Bob LaMonte, will sit down to discuss whether Weis wants to spin his newfound celebrity into a pot of money and, if so, how large a pot.

The Weis era at Notre Dame already has rung up its first major ka-ching. On Oct. 29, as rumors swirled that the coach was being wooed by National Football League teams, the university inked Weis to a deal that runs until 2015 and hikes his pay to above $2 million a year.

Next come decisions about book deals, endorsements, and speaking engagements, for which Weis's fee just went up from $20,000 last spring to $50,000 or more. A book contract could be worth 10 times that, depending on what Weis has on his mind. Random House Inc. editor Mark Tavani was one of the first to suggest a Weis book to LaMonte, halfway through Weis's first season. "If he could speak to the concerns of loyal Notre Dame fans and why they should believe in him, that could be very interesting," says Tavani.

HEAVY BURDEN Weis nearly died after unsuccessful gastric bypass surgery

Up to 50 deals await, including endorsements, speeches, and books

In all, LaMonte estimates that as many as 50 proposals are waiting for the coach—not bad for a guy who,

ough he owns three Super Bowl rings, ad been a virtual unknown outside foot- all circles until this fall. "Charlie cer- inly doesn't own the Golden Dome. But e has the keys for 11 years," says his gent, referring to the gold-topped build- g that is among the most recognized otre Dame landmarks.

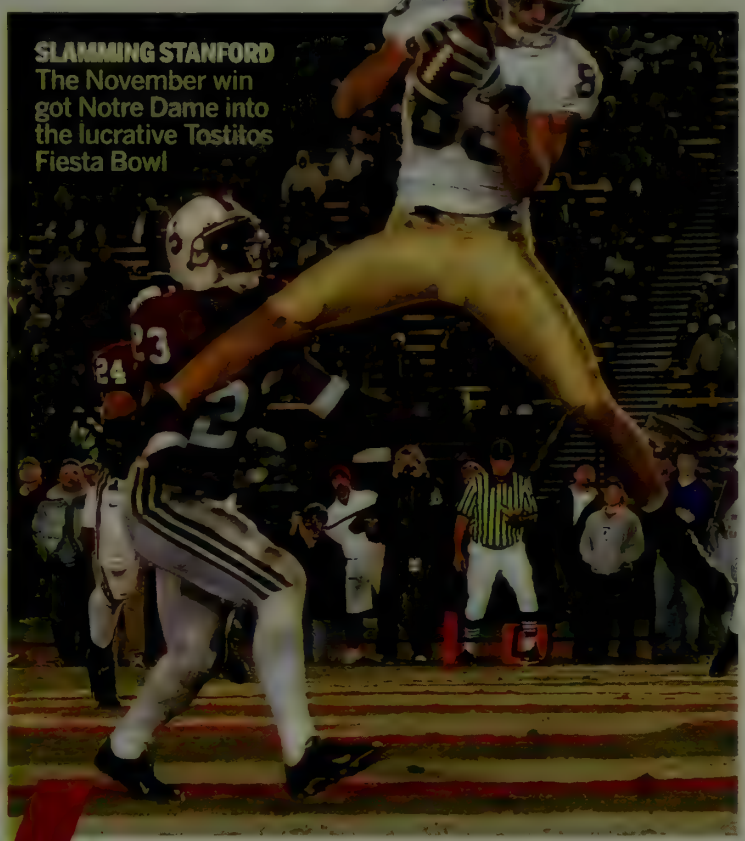
Weis, of course, wouldn't be the first oach to leverage his position at Notre ame. More than 80 years ago legend named Knute Rockne roke new ground by lending is name to a string of football chools and carrying the ball or Studebaker. Ever since, ighting Irish coaches have een sought-after pitchmen nd speakers, sometimes to e annoyance of school offi- ials who wish they'd stick to eir Xs and Os.

INISTER OF OFFENSE

HAT WON'T BE a concern at Notre Dame for the next ecade, predicts the 49-year- ld Weis. "I want to be very ure I don't spread myself too hin.... I think I can be good at ome of these things, but I'm ot going to whore myself ut," he says with typical luntness. Still, Weis has a andy story to tell in after-din- er speeches. When he was in he Class of 1978 at Notre Dame, he didn't lay football—a rarity mong today's big- ime coaches. He ma- ored in speech and rama and dreamed f being a sportscast- r. Then he started ob-hunting. "The noney was so low. The best offer I had was $6,000," he says.

Instead, Weis signed on as a high school English teacher and assistant football coach. After some years of dues-paying, he joined the New York Giants as a glorified gofer under then-coach Bill Parcells. Fifteen years later, Weis had helped coach three winning Super Bowl teams and, as Minister of Offense for the world champ New England Patriots, was one of the hottest candidates for a head coaching job in the NFL.

His moment might have come sooner if he hadn't also been the widest guy on the sidelines each week. "The one thing I've felt a semi-failure about is that I've never been able to control my weight," says Weis, who carried as many as 350 pounds for much of his career. In 2002, concerned that he would die and leave his wife, Maura, and their two children without a breadwinner, he opted for gastric bypass surgery. Complications after the operation almost killed him. Weis was in a coma for two weeks and has since filed a lawsuit against his doctors.



SLAMMING STANFORD The November win got Notre Dame into the lucrative Tostitos Fiesta Bowl

> "Charlie certainly doesn't own the Golden Dome. But he has the keys for 11 years."
> *—Weis's agent, Bob LaMonte*

The coach doesn't shy away from talking about his obesity. "I've probably lost a thousand pounds in my life, no kidding. The problem is I've gained more than a thousand," he says. He also speaks frankly about his daughter, Hannah, 10, who's affected by a condition similar to autism. The Weises' foundation, Hannah & Friends, aims to establish a community for Hannah and others with disabilities. This year alone, Weis has donated $100,000 in speaking fees to the foundation, in part because under his old Notre Dame contract, outside income offset his pay.

His new deal allows him to keep whatever he makes—though he says he'll continue to channel extra income to the foundation. The deal seems in tune with the ethos of the university, where football and All-American commerce have been playing in the backfield almost as long as there has been pigskin in South Bend. Even in 2004, when the Irish limped to a 6-6 record and coach Tyrone Willingham was dismissed, the gridiron generated $41.7 million in revenues, more than 75% of the money spun by the Irish athletic program. Profits of nearly $27 million raked in by football bought a lot of knee pads for volleyball players and sabers for fencers. And those figures will seem paltry when Weis's first season is over. By qualifying for the BCS, Notre Dame receives an extra $14.8 million that will flow into academics.

The business of Irish football is thriving on other fronts, too. This year the streak of sellouts at 80,795-seat Notre Dame Stadium, the hallowed oval a long block from Weis's office, hit 185. Then there are TV and merchandising deals, the richest in college football. NBC pays $9 million a year for home games, which this season pulled in the highest ratings since 1995. NBC Sports President Ken Schanzer calls it a deal he'd like to extend "as far as the eye can see."

Shoe and apparel giant adidas-Salomon is no less eager. Last month it announced a 10-year, $60 million deal extension to sell Notre Dame jerseys and shorts. The dollars dwarf other college licensing deals, including Auburn's recent five-year, $10.6 million pact with sports clothing maker Under Armour Inc. "When you talk to retailers selling huge amounts of apparel, they tell you the No.1 school by far is Notre Dame," says John Shanley, an analyst at Susquehanna Financial Group in New York.

It's all good for Charlie Weis, the man who brought the Irish back from the half-dead. Fortified by his new contract, he's building an eight-bedroom house in South Bend with an indoor horse-riding pavilion (for Maura), a playground and pool (for Hannah), and a regulation baseball diamond (for Charlie Jr., 12). What's in the house for him? That's easy: "Contentment." ■

>ALEX BOGUSKY >>XBOX >>NOKIA N90 >>ED ZANDER >>SLINGE
>TERRY SEMEL >>MARISSA MAYER >>POST-GEOGRAPHIC WOR

BE

WOW, WHAT A YEAR! In 2005 the business world moved to the music of innovation. There were more revolutionary changes in more markets sparked by more breakthrough ideas than at any time since, well, the golden '90s. Admit it: Despite being overworked and dog-tired, you had fun. This year we saw Google and Yahoo! change the paradigm in search, classifieds, publishing, e-commerce, telecom, and video. We watched with awe as Apple blew apart entire distribution networks of established broadcasting and movie empires. We marveled as MySpace came from nowhere to commercialize the coziness of social networks (yet another invention by that key pioneering group, our own teenagers). We took notice when General Electric embraced design, ecology, and creativity as it set out to build a new corporate culture—and generate big profits.

So many fascinating things happened in 2005 that picking the Best of the Best was no walk in the virtual park. And you may not agree with all our selections. But in the pages that follow—and online—we present our editors' choices for the Best Business Leaders, Ideas, and Products of the year. In addition to our top CEOs and managers, there are lists of the smartest business gurus (have you read the latest from Marcus Buckingham?), the best innovation coaches, the best buzzmakers, and the hottest buzzwords. The latter two are online.

The Best Products of 2005 reflect this moment of incredible innovation. Some of you may already be familiar with the video iPod, the Kodak EasyShare digital camera, the Xbox, and the awesome Pontiac Solstice. But have you seen the Slingbox, which lets you watch your living room TV from anywhere? LandRoller skates? The Yamaha Morphous Scooter? For those who have struggled to open a pill bottle, look at the

ST of 2005

It was a vintage year for innovative leadership, creative ideas, and terrific products

newly designed Target ClearRX. Prospective moms and dads should check out the Bugaboo Cameleon stroller. And for everyone there are plenty more hot products online.

The most provocative section, however, may well be our Best Ideas. This year saw more out-of-the-box concepts that changed the competitive game than in nearly a decade. Social networking, the creative economy, post-geographic teams of employees, open-source workplaces, the consumer experience, and innovation efficiency are but some of the fresh concepts that changed the way business is done. Many of these ideas have been around for a while but reached a tipping point in 2005 as companies adopted them to leave their competitors in the dust. And we've added a few extra notions to entertain you: designer puppies, the quest for simplicity—there's even a trend among the wealthy to scale back inheritances before they wind up complicating or even ruining their children's lives.

In the spirit of collaboration, we are also asking for your picks of the Best Business Leaders, Ideas, and Products in an online survey at www.businessweek.com/go/bestof2005. We've laid out our choices for the Best, and we're eager to hear yours.

–By Bruce Nussbaum in New York

BEST leaders

In corner offices, design shops, ad agencies—these executives were ahead of the pack

EDITED BY SUZANNE WOOLLEY

«STEVE JOBS
Apple, Pixar

NO ONE IN TECHLAND had a better year—or a broader impact—than Apple Computer CEO Steve Jobs. Apple continued to set tech's fashion agenda in 2005 with products such as the iPod nano and the video iPod, as well as the Mac mini, Apple's cheapest computer ever. Indeed, no exec sits astride both the technical and creative worlds as much as Jobs, who also runs powerhouse Pixar Animation Studios, maker of megahits such as *Finding Nemo* and *The Incredibles*.

That helps explain why Jobs, 51, was able to persuade Disney to make hit TV shows such as *Lost* available on the video iPod. Within weeks of Apple's coup, CBS and NBC launched their own digital-distribution deals. Disney played ball because it wanted to extend its partnership with Pixar—and because iPods are so hot. Some 10 million are expected to sell this quarter, many at Apple's sleek retail stores, where consumers see and play with Macs. That helped Apple make its biggest PC market share gains in years—and helped the stock price more than double since Jan. 1, to about $73.

TERRY SEMEL
Yahoo!

IT HAS NOT BEEN the typical torrid year on Wall Street for Yahoo! and its CEO, Terry S. Semel. The stock price hovers around $40—up 6% from the start of the year. This, while shares of key competitor Google have more than doubled, to more than $400. But operating in the shadow of techdom's hottest company has its advantages. Semel & Co. quietly toil away, building one of the Internet's most diverse businesses, selling everything from splashy display ads and search ads to online music subscriptions and high-speed Internet access. It's a thriving medley, with net revenues slated to climb 42% this year, to about $3.7 billion.

Meanwhile, the company continues to act on the 62-year-old Semel's penchant for dealmaking, adding Verizon Communications to the roster of telecom partners it teams up with to sell high-speed access. Such deals have boosted Yahoo's legions of paying subscribers to nearly 12 million. Equally compelling, Yahoo has boosted its geek cred and hired a slew of talented search programmers in the past year, which should help the company in its ongoing battle with Google.

ALAN MULALLY
Boeing Commercial Airplanes

IMMEDIATELY after the September 11 terrorist attacks, Boeing Commercial Airplane CEO Alan R. Mulally had difficult decisions to make. The attacks had sent the U.S. airline business into a tailspin. Ultimately, Mulally had to renegotiate delivery schedules for some 500 airplanes, cut jet production by more than half, and fire 27,000 workers. To make things worse, European rival Airbus had supplanted Boeing as the world's No. 1 commercial jet builder and was winning orders for its new A380 super-jumbo jetliner.

Since those days, Mulally, 60, has engineered a remarkable recovery. During the downturn, he focused religiously on cutting waste and streamlining Boeing's antiquated and inefficient airplane production lines. He then bet the company's future on a set of new technologies that are now turning Boeing's superefficient 787 Dreamliner into the hottest-selling new jetliner in history. Next on Mulally's agenda was launching a new version of the venerable 747 Jumbo Jet to compete with the A380. The result: Boeing has captured 800 orders thus far in 2005, compared with 191 last year.

Sure, these successes come in the midst of an industry recovery. And Mulally did fail to avert a 25-day strike by the International Association of Machinists. Even so, he gets credit not only for rescuing the fabled commercial airplane division during its darkest hours but for putting it back on the path to prosperity.

A.G. LAFLEY
Procter & Gamble

SINCE TAKING the helm of P&G in 2000, A.G. Lafley has led a turnaround that continues to defy expectations. The maker of Pampers and Crest has posted earnings and sales growth that lead the industry and put competitors on the defensive. Lafley capped all this in October with the $57 billion acquisition of Gillette.

Lafley, 58, transformed a stodgy, insular culture into one that is nimbler and more open—P&G now gets 35% of its product ideas from outside companies or inventors. It has also outflanked rivals in design and innovation: The company had 5 of the top 10 best-selling consumer-product launches in 2005, says market researcher Information Resources.

KIM SHIN BAE
SK Telecom

IN A COUNTRY where virtually everyone age 15 and over already has a cell phone, it's not easy for a mobile-phone company to keep growing. But since Kim Shin Bae became the head of South Korea's largest mobile-phone carrier in March of 2004, SK Telecom has ventured into new businesses that are now fueling double-digit gains in nonvoice traffic and revenues. In 2005's third quarter, data traffic was 27.6% of mobile-phone revenues, up from 15.5% in 2003.

To arrive at such growth, Kim, 51, opened an online music shop that has 500,000 paid subscribers, set up an affiliate that uses SK's satellite to beam TV programs to the tiny screens of 300,000 of its subscribers, and activated a wireless Internet portal. The portal will offer multimedia services such as video-on-demand, online games, and news feeds. Next year, SK's network will be upgraded to a far faster speed, which should allow more video, games, graphics, and other content to flow across its system. The company is also expanding its reach overseas, in part through a $440 million joint venture with EarthLink that is poised to launch commercial service in the U.S. In 2006 a subsidiary will expand service from three of Vietnam's cities to all of them.

JEFFREY IMMELT
General Electric

THE DEFINITION OF a dream company to Jeff Immelt: One that can be cutting-edge and walk lightly on the planet while still ringing up projected sales of more than $160 billion in 2005. The 49-year-old CEO of General Electric is demanding that his people take risks by coming up with products and services that don't just make small improvements but change the game by creating new markets, developing new technologies, and wooing new customers.

Immelt's GE is built more on biotech and wind power than old-economy ovens and lightbulbs. It's also firmly focused on emerging markets such as China, and its senior ranks are starting to reflect the world's diversity. Now in his fifth year as chairman, Immelt's focus on innovation has transformed GE into a model for how to thrive in the 21st century, much as Jack Welch's GE was an icon in the century before.

KATSUAKI WATANABE
Toyota

IE PASSING of the torch is past June from yota Motor President ijio Cho to Katsuaki atanabe has been as nooth as a Lexus gear x. And why not? atanabe, 63, is a 41-ar veteran who knows yota inside out. The lf-loving executive— has a 10 handicap— ined Toyota right after rning an economics egree from Keio University nd is credited with charting s long-term strategy as eneral manager of the orporate planning division.

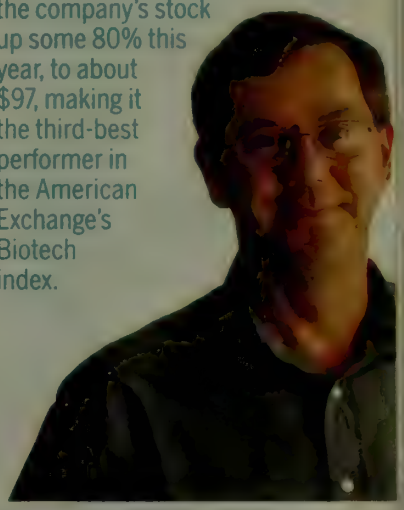
It was on Watanabe's atch in 2000 that Toyota unched a five-year, $10 illion cost-cutting initiative. hat penchant for savings has aved the way for Toyota's ndustry-busting earnings, hich are now being invested into hit vehicles such as the Prius hybrid and into building plants from Canada to China. Sales today are bucking the market downturn—Toyota's U.S. sales rose 10% in November, year over year, while those of General Motors and Ford Motor posted drops of 7.6% and 14.7%. While Watanabe's childhood dream of being a pro baseball pitcher didn't pan out, he's set to achieve something on a far grander scale: Steering Toyota past GM as the world's largest car producer.

ARTHUR LEVINSON
Genentech

BACK IN 2003 investors were urging Genentech CEO Arthur D. Levinson to just give up on the company's experimental cancer drug Avastin, which didn't look promising in some early trials. It's a good thing the scientist-turned-CEO didn't listen. Thanks in part to Avastin, which was approved by the U.S. Food & Drug Administration to treat colon cancer last year, Genentech is on track to chalk up sales of $6.6 billion in 2005—a 42% improvement from 2004, analysts estimate. Earnings, meanwhile, could climb 72%, to $1.3 billion.

Levinson, 55, has always concentrated the company's resources on pursuing science that addresses the largest unmet medical needs. That paid off in 2005 with a string of good news. Genentech achieved positive outcomes in five late-stage clinical trials, which could expand markets for Avastin and Genentech's other cancer drugs. It also got positive data on Lucentis, its experimental drug to treat age-related macular degeneration (AMD), the leading cause of blindness in people over age 55. While Avastin chokes off blood supply to tumors, Lucentis plugs up leaky blood vessels that cause AMD. The company plans to file for FDA approval in 2006.

As Genentech prepares to celebrate its 30th anniversary in 2006, shareholders have good reason to be happy. Investors have pushed the company's stock up some 80% this year, to about $97, making it the third-best performer in the American Exchange's Biotech index.

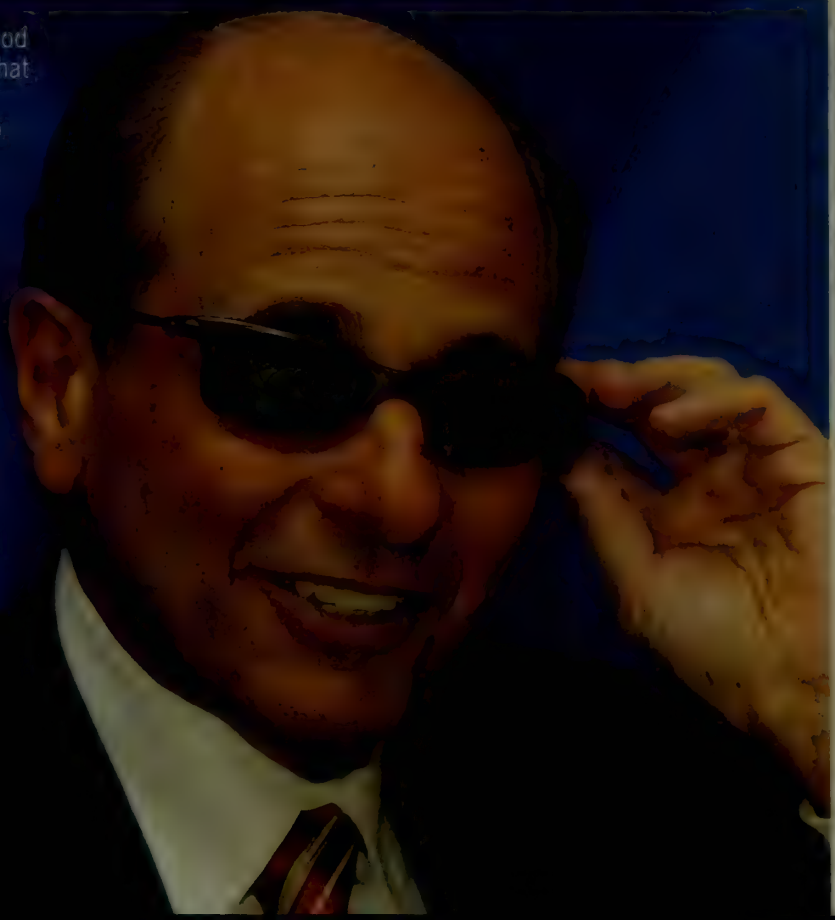


EDWARD ZANDER
Motorola

THE SVELTE RAZR phone was already in the works when Edward J. Zander joined Motorola in 2004. But it was under Zander that it became such a huge hit—and served as the key to inspiring a cultural renaissance at the company.

Zander, 58, brought a new sense of urgency to Motorola that not only got the Razr to market swiftly but also put some 100 million Motorola phones into consumers' hands in 2005. Market share rose from 13.5% in 2004's third quarter, when the Razr was launched, to nearly 19% for the same period in 2005. "It's like a hit song that causes the album to sell," Zander says. "But we have to have more."

To generate chart-busting products, Zander (shown wearing Motorola's Razrwire sunglasses/mobile-phone combo) stresses tight teamwork among business units and tireless customer service. Units used to operate autonomously, and customers didn't always come first. But now that Motorola has a shared vision, it's winning praise from customers worldwide.



buzzmakers

RICHARD PARSONS
Time Warner

FOR THE CHIEF EXECUTIVE of a company whose stock price is essentially the same as when he took over more than three years ago, Time Warner's Richard D. Parsons has done a masterful job of winning praise. For much of 2005, Parsons got credit for putting the world's largest media company back on track after the disastrous merger with America Online in 2001.

The tone of Parsons' press changed in August, when one-time greenmailer Carl Icahn zeroed in on Time Warner's stock price. Pre-Icahn, Parsons got kudos for addressing one problem after another—from reducing debt by selling businesses to settling federal investigations and shareholder lawsuits. He was also seeing a robust Internet advertising market help change the view that AOL was the company's albatross. As news leaked that such industry giants as Microsoft, Google, and Comcast were talking to Time Warner about buying a stake in AOL's portal business, it looked as if Parsons had rid himself of his final demon. Now, if he can just get that stock price up, he may be able to silence even Icahn.

ALEX BOGUSKY
Crispin Porter + Bogusky

EDGY CREATIVE work, including the much-hyped subservientchicken.com campaign for Burger King and the U.S. launch of the BMW Mini line of cars, has earned Crispin Porter + Bogusky a reputation as the hottest ad agency around. So hot, in fact, that executive creative director Alex Bogusky, along with partners Chuck Porter and Jeff Hicks, persuaded Volkswagen of America to simply walk its $400 million account into the Miami agency in September. Like Burger King before it, Volkswagen didn't even ask other agencies to bid for their business.

Creativity magazine has called the Miami-based agency "perhaps the leading creative force in advertising." Bogusky's media agnosticism lies at the heart of the revolution that he and his colleagues are leading. Creative directors had long focused first on splashy, expensive TV ads, then on print and posters, and lastly on radio and the Internet. Public relations and viral marketing? Never. But Bogusky has shredded those notions. For him, great TV= great Net campaign=great idea for a series of live events= great idea for podcasts.

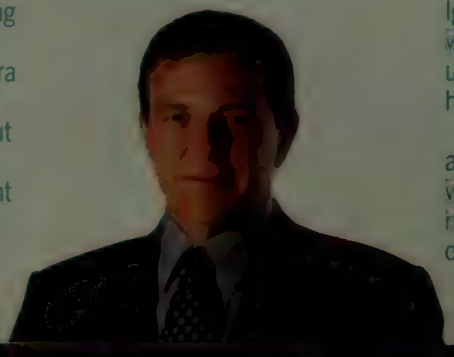
Bogusky is also linking up with creative people outside the advertising business. CP+B bought stakes in two hot branding and design shops, Bruce Mau Design and Yves Béhar's fuseproject.

ROBERT IGER
Disney

WHEN THE FIRST CALL Robert [illegible] of Walt D[illegible] onstage in a San Jose (Calif.) theater to help Jobs announce that Disney was making top ABC shows available on Apple's iTunes on-demand download service. That rewrote TV's long-standing rule of offering shows only on [illegible]tube and opened an Iger era focused on remaking Disney's [illegible] a image. "We can't put [illegible]es on our content [illegible]sumers don't want [illegible]n they can have [illegible]

Few CEOs have moved faster to overhaul a company. Disney is embarking on a $100 million program to beef up its video-game unit, will spend an additional $130 million to launch a line of Disney and ESPN cell phones, and is looking for more deals to distribute its films and TV programming on demand. Iger doesn't even rule out a deal with cable giant Comcast, which unsuccessfully launched a hostile takeover bid in 2004.

Meanwhile, Disney's animation unit has had a hit with *Chicken Little*—giving Iger new muscle in talks for a new distribution deal with Pixar.



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entrepreneurs

CHRIS DeWOLFE & TOM ANDERSON
MySpace.com

LAST JULY, TWO young Los Angeles entrepreneurs hit the Internet jackpot. It was then that Chris DeWolfe and Tom Anderson announced a deal to sell wildly popular Web site MySpace.com and its parent Intermix Media to News Corp. for $580 million.

Two years ago the duo created a site where members can build home pages loaded with messages, bios, pictures, music, and photos. Building on social links to the music industry—Anderson has been in several bands—they started a general-interest site with a strong focus on music. MySpace.com denizens now follow the twists and turns of each other's lives in addictive fashion. The site had 11.6 billion page views in October, making it the fourth-busiest Web destination. It has nearly twice the traffic of Google.

Some feared the site would become too commercial under News Corp. But traffic and membership growth, which leveled off over the summer, have picked up this fall. The number of unique visitors grew 12% in October, to 24.2 million. The secret of MySpace's success? "We've focused on popular culture, not technology for its own sake," Anderson says.

STEWART BUTTERFIELD & CATERINA FAKE
Flickr

FOR ONETIME online-game designers Stewart Butterfield and Caterina Fake, Flickr initially was a lark—a way to let people share photos as they text-messaged. But their sideline took off when they added a breakthrough more social than technical: People could tag their photos and others' with labels, so they could be found and grouped more easily. Communities formed around groupings, helping attract 1.5 million users, 60 million photos—and, last March, Yahoo!, which bought Flickr for an undisclosed sum.

Turns out Yahoo wasn't interested just in photos. "Caterina and Stewart are very good at figuring out how to create communities," says Yahoo co-founder Jerry Yang. One contribution they've already made is helping spawn Yahoo's My Web 2.0, a "social search" site where people can share online searches with others.

BRIAN BEDOL & STEVE GREENBERG
College Sports Television

IN TODAY'S hypercompetitive media world, being able to launch a cable channel from scratch, make it a success, and then sell it to a top network is a rare feat. Being able to do it twice in a decade is extraordinary. But that is exactly what Brian T. Bedol and Stephen D. Greenberg have done. In November, CBS announced it was buying CSTV Networks, a channel and a collection of Web sites, for $325 million. The deal was struck two years after Bedol, a former Time Warner and MTV executive, and Greenberg, an Allen & Co. investment banker and son of legendary Detroit Tiger Hank Greenberg, launched the 24-hour channel with former Nike executive Chris Bevilacqua.

It was quite an encore for Bedol and Greenberg, who in 1997 sold another of their startups, Classic Sports Network, to ESPN for nearly $200 million—again, just two years after they launched it. Today, their onetime startup, now ESPN Classic, is available in 58.3 million homes and is one of the key pillars of the sports network's offerings.

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innovation champs

MARISSA MAYER
Google

MANAGING INNOVATION at Google is an unusual task. Executives give scant direction to the legions of engineers, who typically pursue the projects that excite them most. Google's challenge: Pluck the best ideas out of the engineering ether and nurture them into successful products.

Few managers are as adept at this as Marissa Mayer, Google's vice-president for search products and its 20th or so hire. A programmer by trade, Mayer seeks techies out on their own turf, such as the snack and coffee station outside her office. She also ferrets out promising ideas by holding open office hours three times a week. Mayer, 30, has helped identify and launch key products such as Google's desktop search software and its social networking site. Her challenge, however, will only grow steeper in coming months: Google now has more than 5,000 employees.

RISHAD TOBACCOWALA
Publicis Groupe Media

THE CHIEF innovation officer at ad agency Publicis Groupe Media often warns: "Now, I'm going to give you a lot of bull----." But when Rishad Tobaccowala talks, listeners quickly realize that the Indian-born media guru's insights are no B.S.

Tobaccowala, 47, has long implored clients to focus on how the Web trains consumers to want media, goods, and services in a new way: on demand. Now, the major networks, seeing his [illegible] true, are scrambling [illegible] programming over iTunes, Comcast On Demand, and DirecTV Highlights-on-Demand. Publicis' main media unit has enjoyed the best run of account wins in the business in the past two years, going from handling $9 billion in media budgets to some $14 billion.

STEFANO MARZANO
Philips Design

IN HIS 14-YEAR tenure as CEO of Philips Design, Stefano Marzano has proved that innovation can give a company a crucial edge in a market chock-full of commodity products.

The Italian-born Marzano heads the autonomous creative division of Dutch consumer-electronics giant Philips. Since 1991, he has more than quadrupled employees at Philips Design, to 450, in 12 international offices, making it one of the world's largest creative agencies. He's also overseen a string of commercial and creative successes such as the curvy Senseo coffee maker, launched in 2001, which sold more than 10 million units.

Now he's striving to perfect his ideal of "ambient intelligence"—everyday objects that sense and anticipate our needs. Earlier in 2005 his team scooped up a prestigious design award for its new MRI scanner, which lets patients choose music and décor to calm their nerves during scans. Choices go onto a radio-frequency identification tag patients carry; it automatically adjusts the room's ambience.

MANAGERS TO WATCH

KEVIN BROWN wants companies to use new Net technology for phone calls and much more. Brown's **IPCELERATE** builds platforms that control the flow of all sorts of data through Net phones, from e-mail to video to inventory figures. Expect it to be bought or to head for an IPO.

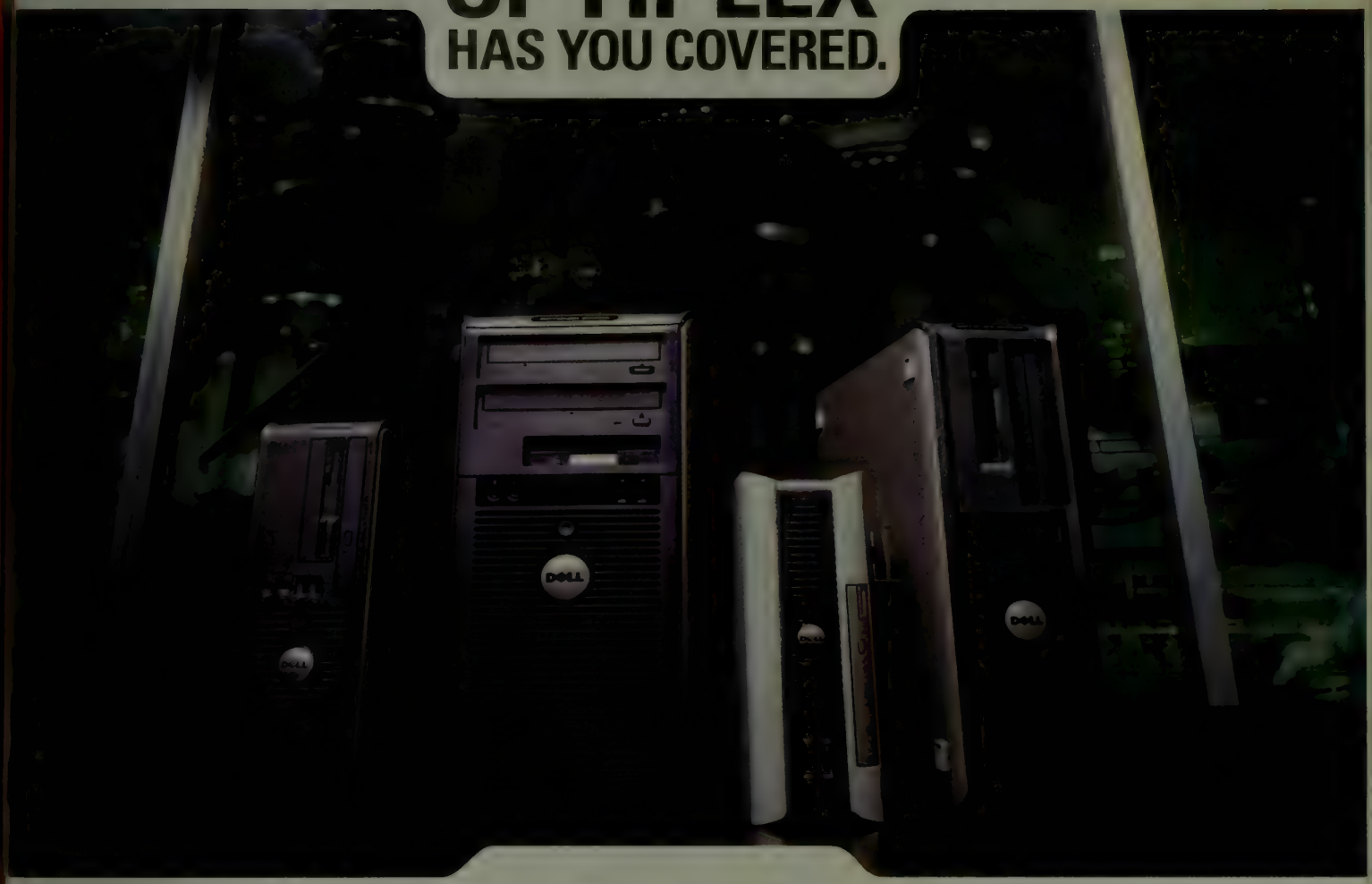
JUDY McGRATH is pushing one of the most successful entertainment brands to find new revenues and ways to reach young audiences. Managing a mature brand is tough, but the CEO of **MTV NETWORKS** sees plenty of opportunities across new broadband and wireless outlets, and internationally.

OLLI-PEKKA KALLASVUO, who is set to succeed Jorma Ollila as CEO of mobile-phone giant **NOKIA** next June, was key in Ollila's transformation of Nokia into a focused, $40 billion (revenue) telecom colossus. With tougher competition from Motorola and Samsung he'll need to launch ever-slicker gizmos while watching costs.

REX W. TILLERSON has big boots to fill when he takes over for Lee R. Raymond as head of **EXXONMOBIL** in January. Tillerson's challenge is to find a way to keep energy consumers happy without flooding the market with crude and ruining ExxonMobil's high-octane reputation on Wall Street.

SHORT-TERM, LONG-TERM,
YOUR TERMS.
IN TERMS OF FLEXIBILITY,
THE NEW DELL
OPTIPLEX
HAS YOU COVERED.

intel inside pentium 4



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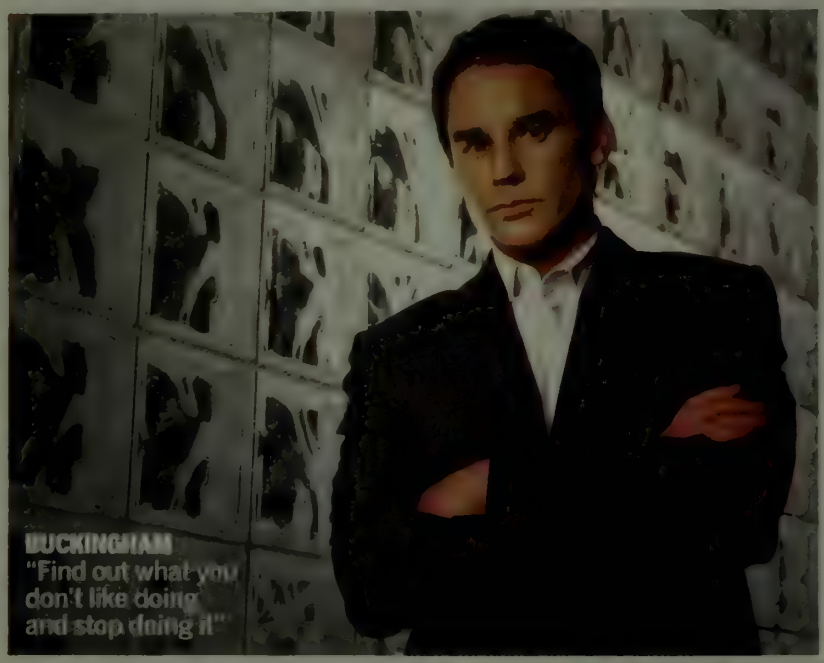
These gurus excel at helping execs tap their strengths and think creatively

THE BEST THOUGHT leaders inspire us to get out of our cozy mental Barcaloungers and engage with the world around us in new, more productive ways. All of a sudden, a fresh look at long-accepted business notions and practices reveals them to be tired, flawed, and limiting. Here are some of the best at helping us expand our mental horizons.

One of the most entertaining writers in the guru business is **Malcolm Gladwell** of *The New Yorker*. His latest book, *Blink: The Power of Thinking Without Thinking*, focuses our attention inward to help us better understand what goes into our snap judgments and to make us appreciate "the weird power of first impressions." In many instances snap decisions are better than more deliberate ones, he shows, though we must try to counter unconscious biases that can interfere.



BUCKINGHAM "Find out what you don't like doing and stop doing it"

Getting perspective on how we make decisions is useful, but to delve more deeply into the art and science of leadership, Big Business turns to strategic thinker **C.K. Prahalad.** Prahalad, with a partner, coined the term "core competence" in 1989. His new mission, laid out in his recent book, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*, is to get multinational companies to realize that the world's 5 billion poor represent a huge growth market for the right business model—and make up a huge pool of future innovators.

Helping executives find their strengths is the focus of **Marcus Buckingham,** who worked at researcher Gallup Organization for 17 years. Buckingham, who published *The One Thing You Need to Know...About Great Managing, Great Leading, and Sustained Individual Success* this year, is working on the third book in a trilogy that started with the best-sellers *First, Break All the Rules: What the World's Greatest Managers Do Differently* and *Now, Discover Your Strengths*, which he wrote with Gallup colleagues. The book will focus on how executives can put their strengths to work on a daily basis.

In Buckingham's new book, which he wrote solo, the Cambridge University-educated Brit explores issues such as the differences between managing and leading. His simple but radical advice for executives: Capitalize on your strengths, not your weaknesses. How? As Buckingham puts it: "Find out what you don't like doing and stop doing it."

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BusinessWeek online

INNOVATION COACHES

TIM BROWN, chief executive of **IDEO,** the largest full-service innovation consultant, heads a prize-winning design powerhouse. The Palo Alto (Calif.) firm's corporate clients range from Nestlé to NASA, and Brown works as a personal adviser to top corporate CEOs.

JENEANNE RAE is the innovation champion's champion. As co-founder and chief innovation officer at **PEER INSIGHT,** a top innovation consultant for service firms, she works as an adviser to top-level innovation advocates within companies. Prior to the launch of Peer Insight, she was a senior management team member at IDEO.

LARRY KEELEY, co-founder and president of **DOBLIN,** a Chicago innovation-strategy firm, is leading the new field of innovation science. By studying the root causes of innovation failures in order to boost "hit rates," Keeley is formalizing the process of innovation.

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BEST ideas

A clutch of concepts—from the whimsical to the life-altering—that came to the fore and could shape the future

EDITED BY DIANE BRADY

TREAT YOUR CHILDREN WELL BUT LIMIT THEIR INHERITANCE

MONEY AND YOUTH can be an unhealthy combination, even if it doesn't propel you and your heiress pals onto a reality show. In fact, popular wisdom now suggests that getting handed a fat check for simply being part of the right family doesn't do much for anyone. With a $41 trillion wealth transfer predicted as baby boomers near retirement, more parents are scaling back massive family bequests, channeling money to social causes instead.

The fledgling movement stems, in part, from spreading symptoms of affluenza. Rich kids have more problems with substance abuse, anxiety, and depression, according to a Columbia University study. More important, many parents increasingly admire the model of Berkshire Hathaway's Warren Buffett or Bill Gates of Microsoft in putting their money to more noble uses. As the rich have become richer, the plight of the disadvantaged has become more evident. Instead of giving a potential complex to a handful of offspring, these parents want to use their wealth—even if it's relatively modest—to help change the world.

GEOGRAPHY IS SO TWENTIETH CENTURY

WHEN IT COMES to work, geography doesn't matter anymore. Even in smaller companies, a growing number o people now operate in teams spread across continents. They use standardized information technology platforms for laptop computers, e-mail addresses,

mobile phones, and intranet access. Whether you're in Singapore or Sunnyvale, Calif., is irrelevant. With portable phone numbers and e-mail addresses, in fact, it can be tough to pinpoint where someone is on the planet. Meanwhile, two people on the same city block can be working in different time zones to serve a far-flung customer base. At 7 a.m., one could be ending the day with a martini while the other munches on cereal.

While the post-geographic world has made it possible for far-flung workers to collaborate like neighbors, there are challenges. Your Shanghai team members may be waking up just as the Chicago-based folks are going home—and London may need you online at 3 a.m. The result is a day that could conceivably span 24 hours, if the limits of human biology didn't kick in. People must learn to work to the ebb and flow of their own schedule—and reach out in new ways. Though geography may have become less relevant, the need for community never goes away.

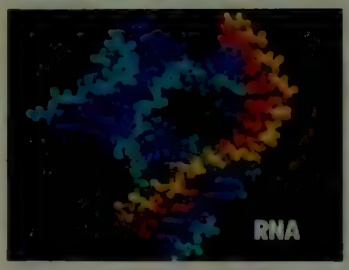
WHAT BUSINESS REALLY CRAVES: SIMPLICITY

THINK OF IT AS option fatigue. Why fumble with one of five remotes in your chip-slicked hands when you can press one button, and *voilà*, it works! Simplicity is the latest buzz in management and design. With the need to work faster and better, who has the time for owners' manuals? Thus a new premium is being accorded to ease of use. The iPod nano nails it. So do Rocio Romero's spartan, up-in-four-days prefab homes and Jura Capresso's one-button espresso makers. Complexity has become a hazard in pushing products. The new trend is to strip things down to their basics and make products intuitive. In 2005, less was more.

THE WAY TO SUCCEED IN THE CREATIVE ECONOMY: INNOVATE

THE KNOWLEDGE Economy is giving way to the Creative Economy. Information has become a commodity like coal or corn. People once thought that superiority in technology and information would ease the economic pain of outsourcing manufacturing to Asia. But it turns out that a good deal of knowhow—software writing, accounting, legal work, engineering—can be outsourced to places like India, China, and Eastern Europe, too. The solution: Focus on innovation and design as the new corporate core competencies. To prosper, companies have to constantly change the game in their industries by creating products and services that satisfy needs consumers don't even know they have yet. That's how loyalty is built. Mastering new design methods and learning new innovation metrics are the keys to corporate success, if not survival. Smart companies now have a senior-level executive charged with driving innovation or sparking creativity. Perhaps it's even the CEO.

DNA IS NOT NECESSARILY DESTINY AFTER ALL

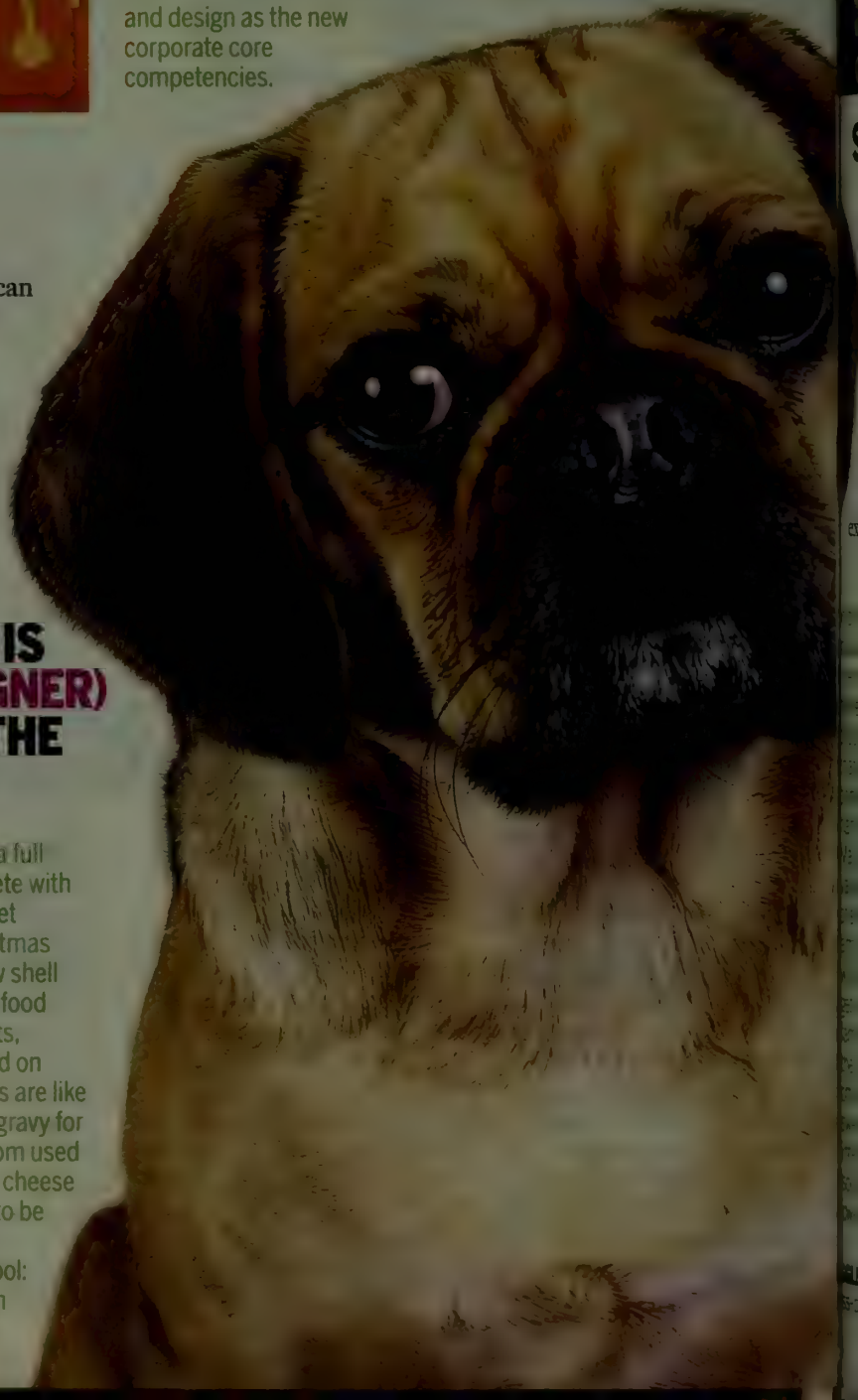


FOR DECADES biologists have inhabited a universe focused on the dogma that genes—and the bits of DNA they are made from—are biological destiny. After all, genes contain the instructions for proteins, the building blocks of life. But the supremacy of genes is under assault.

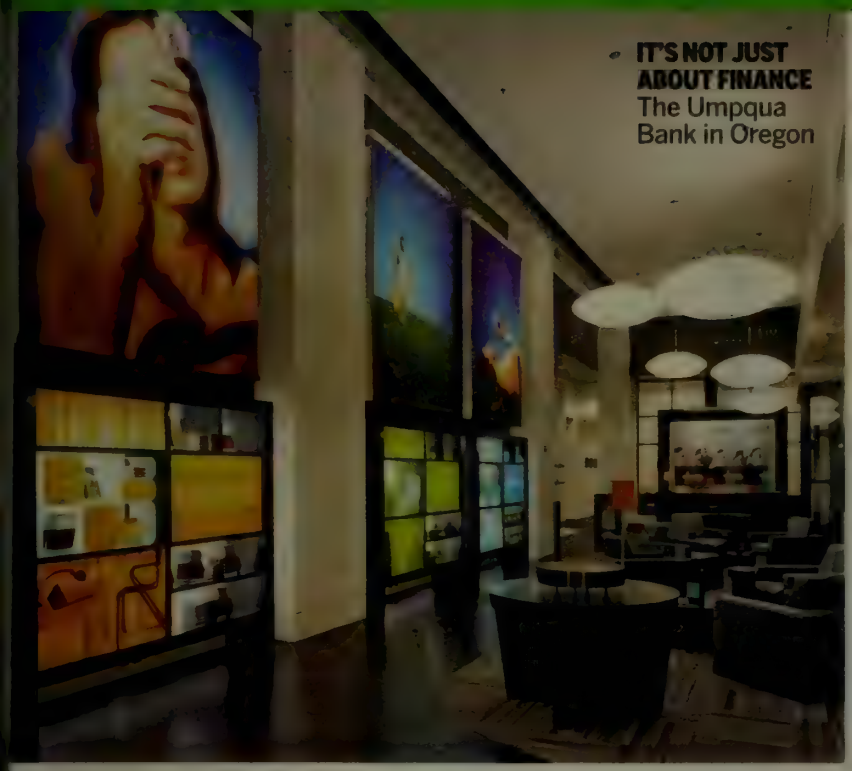
Researchers in the emerging field of epigenetics have thrown new light on the power of chemical and environmental factors to shape how a particular gene acts. That would explain why one person may come down with a gene-related disease while her genetically identical twin will not. In another blow to the gene-centric world, scientists are exploring the power of what used to be called "junk DNA"—the 98% of our total DNA that is found between the genes. It can control important cell functions by creating snippets of a sister molecule, RNA. Drug-related research is increasingly fixated on RNA as well as on traditional genetics.

HOW MUCH IS THAT (DESIGNER) DOGGIE IN THE WINDOW?

THE PET HAS BECOME a full family member—complete with salon shampoos, gourmet meals, and its own Christmas stocking. Americans now shell out $36 billion a year on food and services for their pets, rivaling what some spend on their children. Pet owners are like doting parents who buy gravy for dried food (much like mom used to spice up broccoli with cheese sauce) and push Junior to be [illegible]. [illegible] latest status symbol: [illegible] dogs. After all, in



(TOP TO BOTTOM) ILLUSTRATION BY JOHN HERSEY; KENNETH EWARD/PHOTO RESEARCHERS INC.; CHELLE CALBERT/WWW.CHELLEPHOTO.COM



IT'S NOT JUST ABOUT FINANCE The Umpqua Bank in Oregon

SHOP 'TIL YOU FEEL IT'S A FULL-BLOWN EXPERIENCE

COMPANIES USED TO focus on making new, better, or cheaper products and services—and then selling them in the marketplace. Now, the game is to create wonderful and emotional experiences for consumers around whatever is being sold. It's the experience that counts, not the product. While that business model has long been the preserve of cult-like brands such as Starbucks and Apple, it's fast becoming the norm in all industries. The goal: to build communities of passionate and loyal consumers.

Think of the emphasis on a consumer's individual experience as a final blow to the notion of mass marketing. It's the next step beyond customization of what you make—to shaping people's emotions with what you make. And there's good reason to take the leap. Profit margins are much higher on "experiences" than actual products or services. After all, customers aren't just paying for a cup of coffee at Starbucks or, say, simply doing transactions at Umpqua Bank. They're paying admission to a club—one that delivers something to satisfy the soul. What management thinkers B. Joseph Pine II and James H. Gilmore first identified as *The Experience Economy* several years ago has finally come to pass.

day's world, it's practically an
sult to call Fido a mutt. Unlike
e random pairings of previous
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at are then packaged for their
ombined qualities and given cute
ames like yorkipoos and pomchi.
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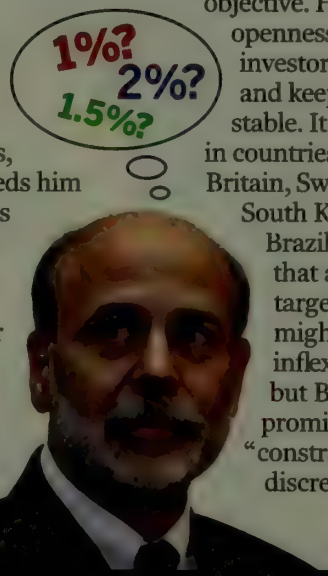
ntelligent, and small. They
ound perfect for apartment-
wellers and they don't ask you
to cough up
for college
later in life.

GLE The latest
s-breed fave

AT BERNANKE'S FED, MORE CARDS ON THE TABLE

INFLATION TARGETING: Out with obfuscation, in with clarity. While Federal Reserve Chairman Alan Greenspan preserved a wizard-like aura of mystery about setting interest rates, the man who succeeds him in January advocates a more transparent approach. Former Princeton University professor Ben S. Bernanke (right) argues that the Fed should announce a target level for future inflation and then issue regular updates on whether it thinks it's on track to hit that objective. He hopes more openness will inspire investor confidence and keep market rates stable. It seems to work in countries such as Britain, Sweden, Canada, South Korea, and Brazil. Critics warn that an inflation-targeting Fed might be too inflexible in a crisis, but Bernanke promises to use "constrained discretion."



GOOGLE WANTS ALL YOUR BUSINESS

Google continues to shake the world of commerce to its core, bringing new ideas and options before consumers. The iconic search engine sparked tremors of fear in every industry from book publishing to advertising in 2005, reinforcing the notion that search is truly the Internet's killer app. When it intertwined satellite imaging technology with a new map service, millions sought out a bird's-eye view of their neighborhood. Constant innovation fuels Google's success, with ideas surfacing around the coffee stations or through informal brainstorming sessions. Engineers can flock to projects that interest them. The company's founders believe in taking a lot of swings—risking numerous failures to get a few home runs. Some new services:

1 SATELLITE MAPS Zoom in on actual photos of your neighborhood or driving route

2 BASE A place to put photos and other information that others can access through search.

3 LOCAL MAPS Standard search results look drab vs. restaurants flagged across a map

4 GMAIL Google's jumbo-size e-mail accounts boast a minimalist interface

5 GOOGLE PRINT Publishers and authors are peeved, but digitizing millions of books will help searchers

(TOP TO BOTTOM) COURTESY OF ZIBA DESIGN; YURI GRIPAS/AP/WIDE WORLD

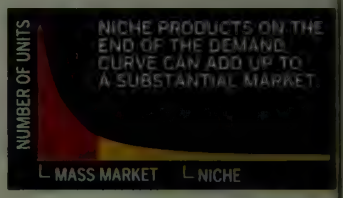
THE POWER AND PROMISE OF THE OPEN-SOURCE WORKPLACE

IN THE OLD gray-flannel organization, the executive suite was where the action was. In what's now known as the open-source workplace, power is distributed. The CEO is no longer omnipotent —and the truly effective ones don't want to be. The best ideas may evolve from the bottom up and sometimes from the outside in. New technologies such as private workplace wikis and blogs are disrupting command-and-control corporate structures. Any employee can create, edit, refine, comment on, or fix an idea. What some used to dismiss as a recipe for chaos is more likely a path to greater productivity. The workplace becomes more transparent as power and information are instantly shared.

Companies are even reaching outside their ranks to the virtual commons. Online fan clubs help LEGO Group design toy kits, so they sell out fast with no marketing. Procter & Gamble executives tap the wisdom of online crowds at InnoCentive, a Web network of 80,000 scientists, to find solutions for problems that stump their own staff. Such "peer production," as some call it, creates value out of social behavior. In the new office, products, business plans, and even meeting agendas are created collectively instead of individually.

HOW THE NET CAN FIND MARKETS FOR THE OBSCURE

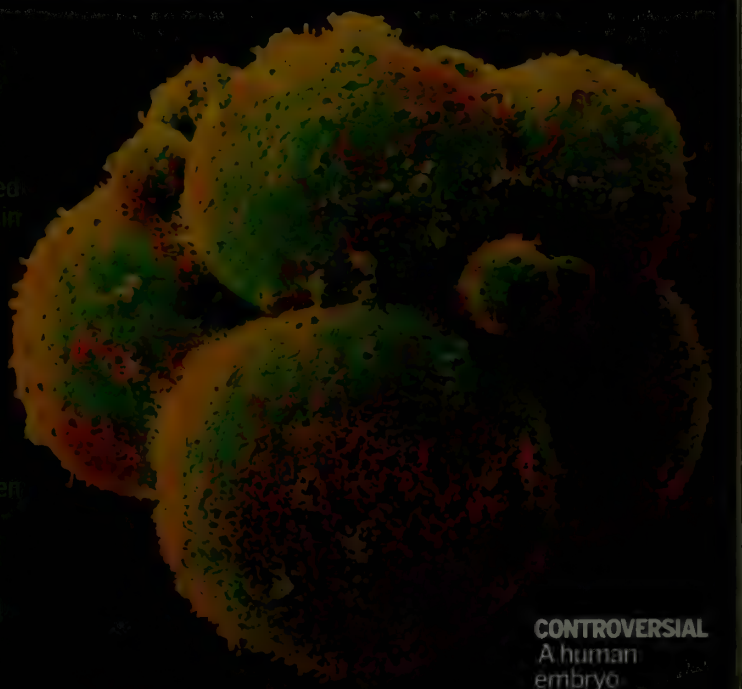
THE MASS MARKET is no longer supreme. Thanks to the Internet you can also make money in the niches. That's the notion behind the "long tail," a term coined by *Wired* magazine Editor-in-Chief Chris Anderson to describe how the Net has made the lengthy list of low-selling products—the tail of the demand curve—as lucrative as hits. How? The Net's ability to gather global demand for niche products means those niches can now sell enough in total to be substantial markets. Amazon.com's recommendation service, for instance, makes hits out of once obscure books such as *Touching the Void*, while Netflix has made successes out of documentaries such as *Daughter From Danang*.



Amazon CEO Jeffrey Bezos estimates that 20% of book sale are from outside the 130,000 titles sold in chain superstores. That's a market that scarcely existed before.

TAKING THE QUALMS OUT OF STEM CELL RESEARCH

MOST OBJECTIONS to research on embryonic stem cells revolve around one simple issue: the need to destroy human embryos. But these arguments might [illegible] well. Issues could be [illegible] that researchers have [illegible] cloned babies [illegible] and elsewhere propose solving the problem by tweaking a standard cloning technique called nuclear transfer. In this technique, a nucleus is extracted from a "donor" cell and placed in an egg whose nucleus was removed, thus creating a clone of the donor. In the new approach, scientists would switch off a gene in the transferred nuclear material before placing it in the egg. The result would be an embryo that never becomes a baby. Then scientists could extract stem cells matched to the individual without destroying a viable embryo. Those cells could then [illegible] damaged tissues.



CONTROVERSIAL A human embryo

(TOP TO BOTTOM) ILLUSTRATION BY JOHN HERSEY; KENNETH EWARD/PHOTO RESEARCHERS

IETWORK
he largest and fastest
ational wireless data network.
he largest U.S. provider on
ne global standard.

EXPERTISE
Our people and partners make wireless work for more businesses than any other wireless carrier.

APPLICATIONS
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PLAYING TONY HAWK The skateboarder has lent his cachet to a game set in virtual L.A.

PLAYSTATION MEETS POP CULTURE

VIDEO GAMING, that smash-it-up staple of Americana, is drawing big advertisers and shaping the broader culture. Games feature stars such as skateboarder Tony Hawk (above) and actor Sean Connery, who lent his voice to the new James Bond game *From Russia with Love*.

Now, Electronic Arts has developed the Next Level Music label to sell music from its games for use in television commercials and for phone companies as ringtones. And major advertisers from Coke to Verizon have signed on, with a new video game ad network created by Massive Inc. to place advertisements in games. No wonder Hollywood is rushing in. Director Peter Jackson's next project after *King Kong:* producing a film based on Microsoft's blockbuster game *Halo*.

FAB FAKES AND CHEAP CHIC HAVE CREATED MASS CLASS

TIME WAS WHEN gauging class was as simple as eyeing handbag provenance: old money in Hermès Kelly Bags; strivers in Coach; bottom-quintilers in Kathie Lee. The poor shopped at discount stores while the rich sashayed down Rodeo Drive. What a difference celebrity magazines, the Internet, designer brand extensions, easy credit, and Chinese counterfeits make. High and low are slamming into one another, creating a new world of mass class wherein Karl Lagerfeld designs one collection for the runways and another for interns shopping at H&M. Technology is both homogenizing good taste—bringing magisterial sensibilities to the remotest backwaters—and making it more affordable. The appetites of high net worths and the less well-heeled aren't merging only in fashion. Consumers of all classes buy their ketchup at Costco and organic beef at Whole Foods. Pity the nondescript retailers and brands in the middle.

REACHING THE SIMULTANEOUS MEDIA MULTITASKING CONSUMERS

IT USED TO BE that your teenage kids were the only ones listening to music, zipping off instant messages, searching the Internet, and talking on the telephone all at the same time. But the explosion of technology and choices has pushed media multitasking across the generational divide. Everyone is now a simultaneous consumer of media. Those [illegible] patterns of [illegible] challenges and [illegible] opportunities for [illegible] that [illegible] the [illegible] [illegible] struggle [illegible] "[illegible]" [illegible]—the latter being a fade-in, fade-out form that grabs consumers' attention only occasionally. Think of the TV show that runs at a low hum while you work on a computer. Or the podcast that plays between telephone calls. The challenge: projecting the effectiveness of any given message in this multilayered world. Perhaps background media should be priced lower than foreground media. A more radical thought: With multiple layers of media [illegible] [illegible]nce, we have [illegible] more hours of media coming at us in a 24-hour time frame. What's the business model for that?

(TOP) JAMIE McDONALD/GETTY IMAGES FOR LAUREUS; (INSET) KRT. (BOTTOM) CHIP SIMONS

WHERE YOUR KID IS HANGING OUT ONLINE

FORGET THE MALL. The hottest place for the under-24 crowd dubbed Generation @ to socialize these days is at MySpace.com. The social networking site drew 24.2 million visitors in October, making it one of the most popular on the Web. For today's wired youth, there is no distinction between virtual and physical reality. They have helped to spawn more than 300 networking destinations on the Web.

Such sites are cyber-community centers where kids blog about breakups, make plans for Friday night, and get advice on the best shoes. For them, maintaining an online social presence is critical to navigating the offline world. No wonder companies are clamoring to get inside by posting ads or, as Rupert Murdoch's News Corp. did in July, buying MySpace parent company Intermix Media. At the workplace, this generation also relies on social networks to make job connections and collaborate in new ways. So log on. Or get left behind.

EMPLOYEES WHO MARCH TO THEIR OWN MUSIC

ES, *Let My People Go Surfing* a memoir of Patagonia's ountain-climbing founder, von Chouinard. But the 005 book is also a heartfelt lea for capitalism, ethics, nd fun to coexist in the orkplace. The privately held entura (Calif.) clothing ompany lets employees take reaks if the surf is good or a esh snowfall creates an nmediate desire to ski; the eather won't wait, but the ork usually can.

Chouinard firmly believes hat smart, capable mployees know how to get heir work done and can idge the rhythms of their day without constant monitoring. This conviction has less to do with work-life balance than with the acknowledgment that work flow and passions are unique to each person. He's also acutely attuned to preserving the planet's resources, even inserting notes in Patagonia catalogs asking customers to buy only what they need. It's a philosophy that resonates in an age of global networks, round-the-clock communications, and growing evidence that the earth is straining under the excesses of human behavior.

BOARD MEETING Patagonia staff

GROWING GREENER

Whether it's because of devastating hurricanes or those $3-plus gas prices, many feel it's time to get serious about earth-friendly practices. Concerns over global warming are on the rise. And corporate leaders are at the forefront of pushing new ideas to slow climate change. From big-ticket gambles on new technologies to long-term commitments to cut greenhouse gas emissions, a growing raft of companies bet they can profit from going green. Among them:

1 TOYOTA Home of the hybrid Prius and on track to hybridize its entire line of vehicles. Others are playing catch-up

2 GENERAL ELECTRIC With its ecomagination push, GE wants to profit by delivering innovative, higher-efficiency products from windmills to hybrid trains

3 ALCOA Over the past decade, the world's largest aluminum maker has slashed its greenhouse gas emissions by 25%

4 BP Europe's biggest oil and gas producer has made cleaner, greener energy the center of its corporate identity

5 HSBC After cutting back on energy use, the bank is helping its clients assess environmental liabilities and trade CO_2 credits to help cut greenhouse gas emissions

TUNING IN TO THE CHANNEL OF ME

WE INCREASINGLY live in an era of one channel, the Channel of Me. All the great centralized means of distribution—from broadcast TV and magazines to retail chains and radio—are being transformed by technology that allows individuals to create their own unique program lineups and media experiences.

In a mobile, digital world, people want to shape their own channel by choosing from all the available content out there. They want companies to sell them capabilities and options, not uniform products. Each person can build a personal music library, shopping experience, or TV schedule. Users will collaborate instantaneously with others around the globe. Business is there to provide the tools. The Channel of Me makes consumers the ultimate producers.

RADIO DREAMS COME ALIVE IN THE PODCAST

SAY YOU'RE CRAZY about wine. Along comes some free technology that makes it a snap to create your own radio show and distribute it over the Internet. On a whim, you decide to do a show on wine from your living room, call it GrapeRadio and, within months, have more than 10,000 weekly listeners.

Before last year, that would have been the stuff of daydreams. But in July, 2004, so-called podcasting software released by former MTV VJ Adam Curry democratized radio and let loose a wave of dormant creativity. There are now more than 20,000 podcasts online on topics from learning French to Scottish music. Although championed by indies, podcasting has been adopted by media giants such as Clear Channel Communications, Walt Disney, and National Public Radio. Everyone is trying to figure out how to make podcasting pay. As with bloggers, few podcasters are likely to make money. Even so, thousands can now create free content that will compete with traditional media for listeners' attention.

BLOGGING THE BRAND

Until recently blogs seemed to represent the strident, angry, self-obsessed partisan—and, occasionally, the unhinged. But corporations have figured out that tapping into the blogosphere is a great way to build relationships with customers and suppliers. Some are even encouraging employees to post their musings on the Web to showcase their expertise and reach new audiences. Properly done, such blogs can lead to more democratic, transparent operations. Have there been some boneheaded moves, such as ads disguised as blogs? Sure. But as the blog world has doubled in size every five months, companies are finding they can use its power to manage crises and build communities around their brands. Some notable ones:

1 GM'S FASTLANE Vice chairman Bob Lutz's insider look at the auto giant (fastlane.gmblogs.com)

2 SCOBLEIZER An employee blog at Microsoft, by Robert Scoble (scobleizer.wordpress.com)

3 PUBLIC EYE CBS News's attempt to raise its profile on the Web, where it's under constant attack (cbsnews.com/sections/publiceye)

4 VESPAWAY Piaggio Group has built a marketing blog around its Vespa scooters (vespaway.com)

5 WAL-MART FACTS One chain used blogs to coordinate Hurricane Katrina relief (walmartfacts.com)

(TOP) JAMIE MCDONALD/GETTY IMAGES FOR LAUREUS;

WE EAT WORMS FOR MONEY.

Seriously.

You have enough on your plate already.

Yet e-mail security keeps getting more out of control. Worms, spam, user licensing, viruses, spyware, pornography, malware, updating. It's an expensive and endless headache. And the stakes get higher every day. Today, 8 out of 10 businesses get hit.[1] And e-mail viruses alone are responsible for more than $10 billion in lost productivity.[2]

It's time this problem got solved. Not just for big businesses, but for any size business. Not just for this platform or that. And not by making already overworked IT people run CDs from PC to PC during virus frenzies. It's time for something new.

It's time for e-mail security as a service.

Getting e-mail security from IBM is now about as easy as getting cable TV. You call IBM or sign up on the Web, and IBM does the rest. It's that simple.

Starting at $1.80 per e-mail address, per month, the IBM Express e-mail security service filters out spam and intercepts viruses, pornography and malware *before* they ever get to your network. And, because it's a service, you don't have to buy, upgrade or manage any software or hardware.

Security goes from chronic fear to IBM-grade reassurance. Licensing and upgrades become a thing of the past. So do unplanned costs. Three less things to worry about. Just like that. For any size company.

Soon, everyone will buy security as a service. To help you get there, you can try IBM Express e-mail security service at no charge for 30 days.*

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BEST products

Golf balls that don't go missing, a computer pooch you needn't pick up after, whole-grain white bread: 2005 brought a flurry of innovative surprises

EDITED BY LARRY ARMSTRONG

>>DETROIT'S REVENGE

Pontiac Solstice roadster

If you think General Motors can't design hot cars, take a look at the 2006 Pontiac Solstice. With a peppy four-cylinder engine putting out 177 horsepower, this little convertible is a racy, muscular take on the European roadsters of decades past. It's a great value, to boot: The sticker starts at $19,995 and barely tops $25,000 fully loaded **(800 762-2737, pontiac.com).**

YOUR PICTURE HERE

Stamps.com PhotoStamps

Upload a photo to Stamps.com, and you can have your mug on a stamp valid for U.S. mail. The premium for a sheet of 20 runs from $5 to $10 over the cost of the postage, depending on how many you order **(888 434-0055, photostamps.com).**

SAY CHEESE!

Nokia N90 cell phone

When it comes to camera phones, the $400 N90 is in a class by itself. Only Nokia has optics from legendary German lens-maker Carl Zeiss. With a few twists, the phone turns from a clamshell into a camera. It also surfs, plays music, and makes video calls **(888 665-4228, nokia.com).**

HOT WHEELS
Yamaha Morphous scooter

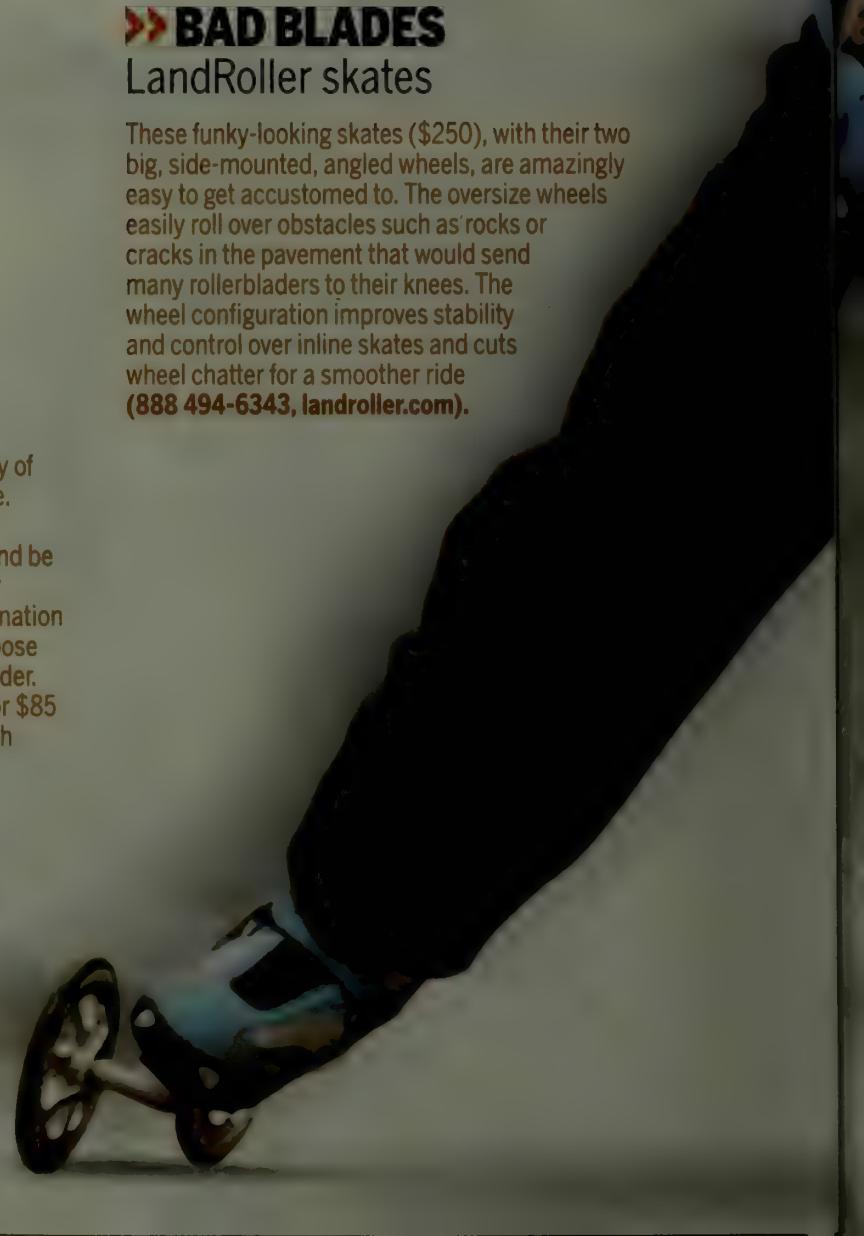
At first glance, it looks as if someone stretched a scooter. But Yamaha's $5,199 Morphous is a factory-built original. The longer, lower, swoopier design affords stable handling, plenty of space for a passenger, and a cavernous trunk (for a scooter, that is). There's enough power, too, thanks to a compact and fuel-efficient 249-cc, 4-stroke engine **(800 962-7926, yamaha-motor.com).**

BAD BLADES
LandRoller skates

These funky-looking skates ($250), with their two big, side-mounted, angled wheels, are amazingly easy to get accustomed to. The oversize wheels easily roll over obstacles such as rocks or cracks in the pavement that would send many rollerbladers to their knees. The wheel configuration improves stability and control over inline skates and cuts wheel chatter for a smoother ride **(888 494-6343, landroller.com).**

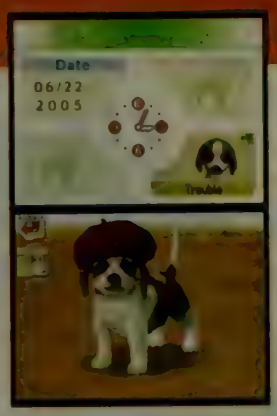
CANDYGRAM
My M&M's

Maybe you just want your own supply of M&M's, personalized with your name. Or maybe you want to send someone else a message and be sweet about it. You get your pick of 15 colors or a combination of any two, and you can compose two separate two-line phrases per order. The price is $38 for four 8-oz. bags or $85 for 20 silver tins that hold 1.6 oz. each **(888 696-6788, shop.mms.com).**



>> DOG DAYS
Nintendogs video game

The first title to take full advantage of Nintendo's DS game system, Nintendogs ($30) is oddly compelling. Use the touch screen to pet your pooch. Voice recognition lets you train it. And the wireless link allows your puppy to play with other owners' dogs **(800 255-3700, nintendogs.com).**



>> GAME OVER
Microsoft Xbox 360

Besides the wow factor of its elegant hourglass design, the $400 Xbox 360 is a pretty amazing gaming machine. It's the first console to take advantage of high-definition technology, so game play is visually stunning. What's more, you can hook it up to your home network and turn the digital pictures on your computer into a slide show on your TV **(800 469-9269, xbox.com).**

(BOTTOM RIGHT) AARON GOODMAN

>> FUN IN THE SUN
Coppertone spray sunscreen

No messy pumps. No slippery bottles. No greasy hands. Coppertone Continuous Spray Sunscreen, about $10, goes on as a clear mist with no white streaks and no rubbing. The new compressed-air bottle will even spray upside down, making it ideal for hard-to-reach places—like your own back. There's also a Sport version for sun protection that's sweatproof **(800 842-4090, coppertone.com).**

WIRELESS SNAPS
Kodak EasyShare-One camera

Kodak, which practically invented photo sharing, has come up with the best way yet. This $600 point-and-shoot camera can seamlessly connect to a Wi-Fi network in your home and T-Mobile hot spots in coffee shops and airports to e-mail snapshots to friends and family or to browse albums in your online gallery **(800 235-6325, kodak.com).**

ALL EARS
Plantronics Discovery 640 Bluetooth headset

At $150, it's a bit pricey for a cell-phone headset. But what sets this model apart is its unusual charging options. There's a tiny carrying case (it vibrates when the phone rings) and charging base. There are adapters so you can recharge it with the charger that came with your phone. And there's a nifty gizmo to recharge it from a AAA battery **(800 544-4660, plantronics.com).**

TV FOR THE ROAD
Sling Media Slingbox

Stuck in a hotel in Paris but aching to see the football game being played back home? Road warriors can now be couch potatoes, too, thanks to the $250 Slingbox. Hook it up to your TV or set-top box at home, and it will beam live broadcasts or recorded shows over the Internet to any PC in the world. You need to install the SlingPlayer software on your laptop or, soon, your PDA. You also need to find a high-speed Internet connection on the receiving end. But then you've got TV anytime, anywhere **(877 467-5464, slingmedia.com).**

STROKE SAVER
RadarGolf golf ball finder

For every golfer tired of searching for errant shots—and the inevitable penalty stroke when you can't find your ball—there's now a high-tech way to track them down. RadarGolf's golf balls are embedded with a chip that emits a radio signal to a handheld device, which then directs golfers to their ball. (The ball conforms to USGA specs and is comparable to Callaway's HX Red.) Cost: $350 for the handheld scanner and the first dozen balls. Replacements are $40 a dozen, but it should be many rounds before you need to reorder **(888 723-2701, radargolf.com).**

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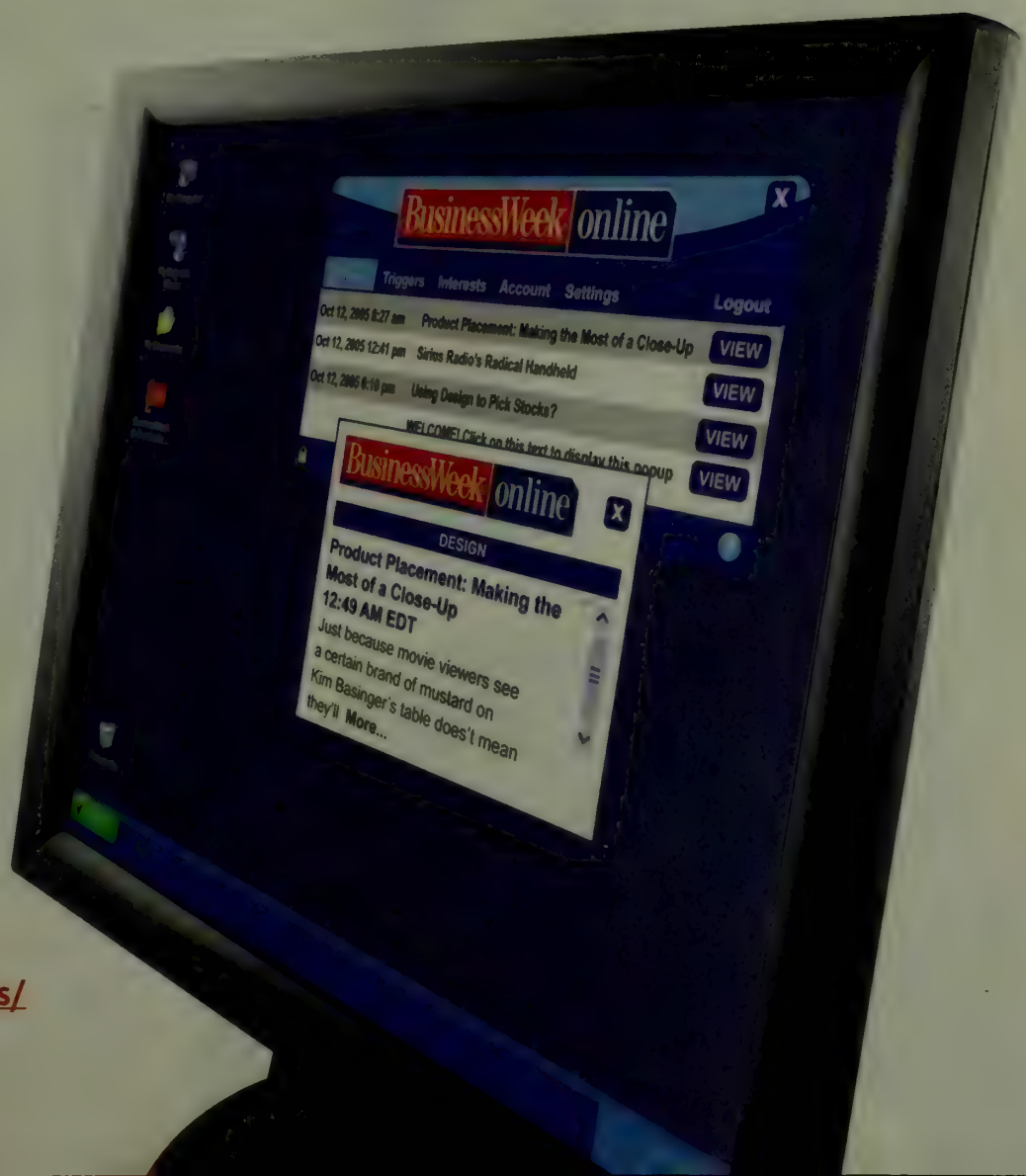

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ww.businessweek.com/alerts/

<< TRANSFORMING TENTACLES
Power Sentry PowerSquid power strip

PowerSquid, with five flexible, grounded outlets on 6-to-10-in. cords, solves the biggest problem with those boring rigid power strips: The bulky transformers that come with most electronic gear hog all the space. This one, available in designer colors, sells from $10 to $15. And it has legs: Next year, PowerSquid will evolve into a cephalopod surge protector **(800 852-4312, powersentry.com).**

>> SHAPE- SHIFTER
Bugaboo Cameleon

The Rolls-Royce of baby buggies, the Cameleon has all-terrain wheels and shock absorbers to help you navigate in comfort. It also morphs into a car seat, a two-wheeled beach walker, or a pram that lets babies lie flat—gear that could easily add up to more than the $879 price tag **(800 460-2922, bugaboo.com).**

>> GOOD AS GOLD
Everbank Gold Bullion CD

Looking for a low-risk play on the hot, highly volatile gold market? It's a five-year, FDIC-insured certificate of deposit with the interest rate tied to gold bullion. Your earnings depend on the average price over the next five years. So if gold is $500 per ounce when you start, and the average is $600, the CD pays off at 20%. If the average falls below $500, you get your principal back. Minimum investment is $1,500 **(888 882-3837, everbank.com).**

<< HOUSE OF SOUND
Sonos Digital Music System

This just may be the easiest way to play your music in any room in the house, and it's certainly the most elegant. The controller, with its iPod-like scroll wheel, lets you pick tunes from your PC and send different songs to different rooms, all without wires. A starter kit, with one controller and players for two rooms, runs $1,200; two sets of bookshelf speakers are $300 more **(800 680-2345, sonos.com).**

(BUGABOO) TOM HAYNES; (GOLD) DIGITAL VISION/GETTY IMAGES

NEW PRESCRIPTION
Target ClearRx bottle

Design-conscious Target decided to turn the lowly prescription bottle on its head. The result is an easier-to-use, easier-to-read container. The flat front means you don't have to rotate the traditional cylindrical bottle in your hand to read it. Medical warnings are on the back, along with a built-in sleeve for a card that summarizes uses and side effects. Colored rings around the neck help prevent mixups among family members **(800 800-8800, target.com).**

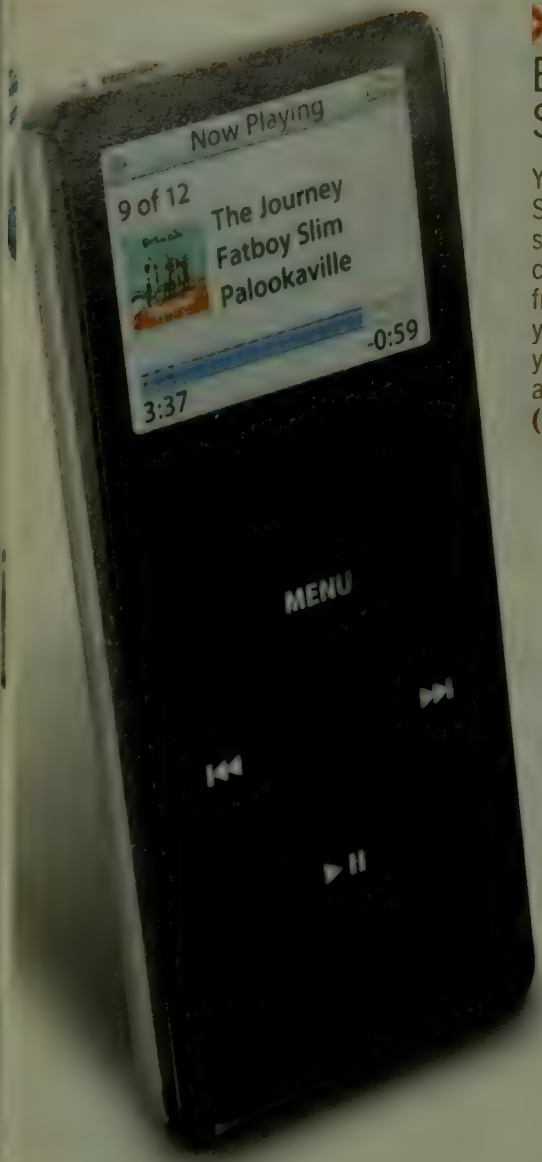
VIDEO ON DEMAND
One-Time-Use Video Camcorder

If you're caught without your camcorder or just don't want to haul one around, here's an option. Drugstore chains CVS and RiteAid sell a recyclable, single-use digital one made by Pure Digital Technologies for $30, plus a $13 processing fee for transferring your movies to a DVD. Don't expect movie theater quality, and be sure there's plenty of light for indoor videos. It fits in a shirt pocket, it has a 1.4-in.-screen for playback (you can delete your duds), and its 20-minute limit is plenty for most home movies **(800 746-7287, cvs.com; 800 748-3243, ww.riteaid.com).**

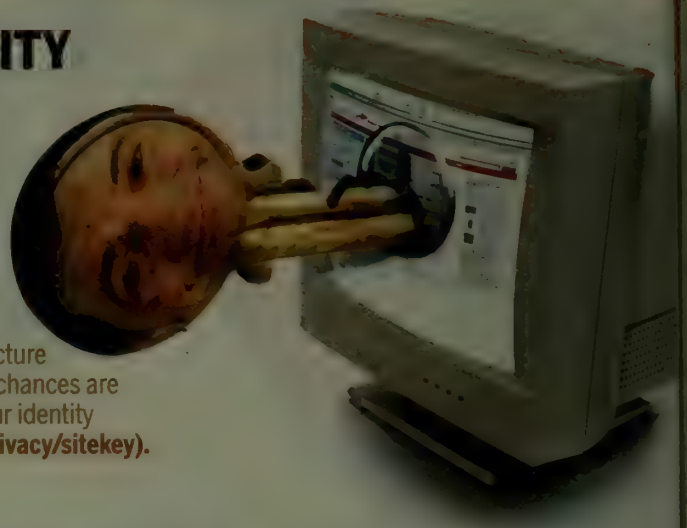
CYBER-TRAINER
EyeToy: Kinetic fitness program

If you can get the Sony PlayStation 2 away from the kids, here's a video game for the older set. Priced under $50, it's a video workout program. But unlike usual fitness flicks, the EyeToy camera puts you on the TV screen, often next to a personal trainer who guides and assesses your performance **(800 345-7669, eyetoykinetic.com).**

(TOP RIGHT) DAVID RUDES/BW (2)



HIGH SECURITY
Bank of America SiteKey



You know it, and it knows you. SiteKey is a new two-step sign-in that protects online customers from ID theft and fraud. If the bank recognizes your computer, it displays a picture you have chosen. If it doesn't, chances are a phony site is phishing for your identity **(800 792-0808, bofa.com/privacy/sitekey).**

SETTING A NEW STANDARD
Infiniti M45 luxury sedan

Infiniti set its sights on the BMW 5 Series sedan and bested it. The $47,600 base car, with a lusty 335 horsepower V-8, has plenty of luxury amenities. But it's the optional technology—lane departure warnings, voice-controlled navigation, and intelligent cruise control—that sets it apart **(800 662-6200, infiniti.com).**

THIN IS IN
Apple iPod nano

Welcome to Apple's take on the flash memory MP3 player: There's no question it's an iPod, but it's impossibly thin—and expensive. The 4-gigabyte model, the world's first 4GB flash player, holds about 1,000 songs and costs $249; the 2GB version is only $50 cheaper. It has a big color screen for your photographs. And, man, is it thin **(800 692-7753, apple.com).**

FLOUR POWER
Sara Lee Soft & Smooth whole-grain white bread

O.K., so it's just a tad more tan than white bread, but it has the same texture and taste. And it smooshes the same way, an important factor for passing the kid test. The difference? Made with a blend of refined white flour and a new white, whole-wheat flour from ConAgra Foods, this $2 loaf has the whole grain and fiber that old-fashioned white breads lack **(800 889-3556, saralee.com).**

BusinessWeek online

For a look at runners-up to 2005's Best Products, go to businessweek.com/extras

For more on the Best of 2005, watch *BusinessWeek Weekend*. Check your local listings, or go to businessweekweekend.com to view this and other stories from our weekly TV program.

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of entertainment
would we like?
Somebody live.
Doesn't matter who,
just somebody live,
so we know that
somebody's thinking
about us.

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Today, millions of children in developing countries are suffering with cleft lip and palate. Condemned to a lifetime of malnutrition, shame and isolation.

The good news is that virtually all of these children can be helped. This is the mission of The Smile Train. We empower local surgeons to provide this life changing free cleft surgery which takes as little as 45 minutes and costs as little as $250. It gives desperate children not just a new smile—but a new life.

100% of your donation goes toward programs — 0% goes toward overhead.

YES, I want to give a child a second chance at life.

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❒ $125 Covers half the cost of one surgery. ❒ $___ We'll gratefully accept any amount.

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Account No. _____ Exp. Date _____
Signature _____

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P.O. Box 96231
Washington, DC 20090-6231

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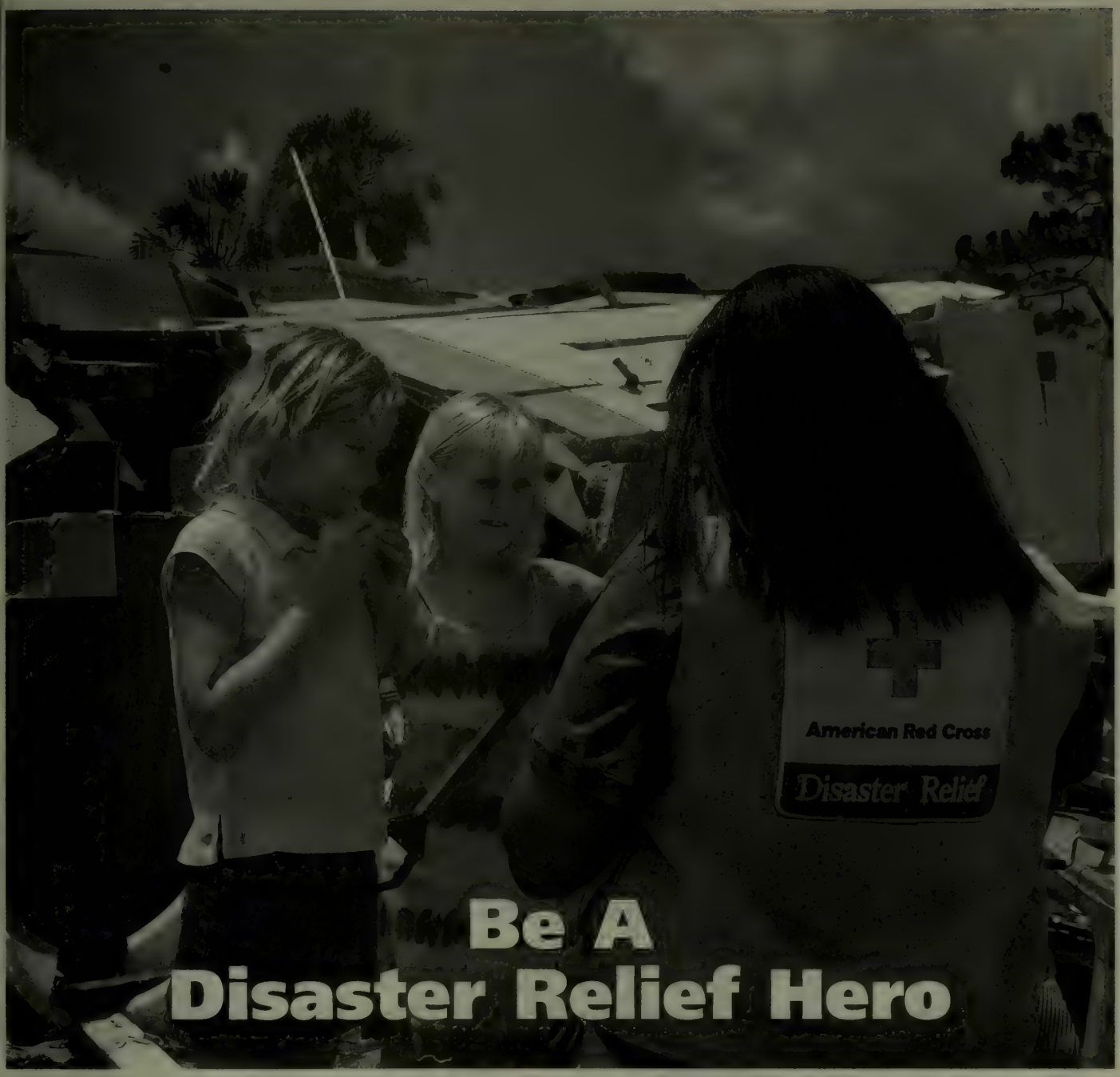

Victims of the recent hurricane need help immediately. The **American Red Cross** is on the scene—providing shelter, food and counseling. But your help is urgently needed. Your contribution will help the victims of the recent hurricane and thousands of other disasters across the country each year.

Make a financial contribution to the Disaster Relief Fund.
Please contact the Red Cross at

1-800-HELP NOW

redcross.org

American Red Cross

Together, we can save a life

WHEN THE PARTY
OVER
WE'RE JUST GETTIN
STARTED
Most people know us for our annual Academy Awards® night celebration in San Francisco. But our real work begins when the music stops and the crowd heads home. Since our founding, Academy of Friends has distributed nearly $5.5 million to Bay Area HIV and AIDS service organizations. With the help of our hard-working volunteers, generous corporate sponsors, and contributions from people like you, we'll keep raising money until the pandemic is over.
And we'll have a damn fine time doing it.
ACADEMY OF FRIENDS
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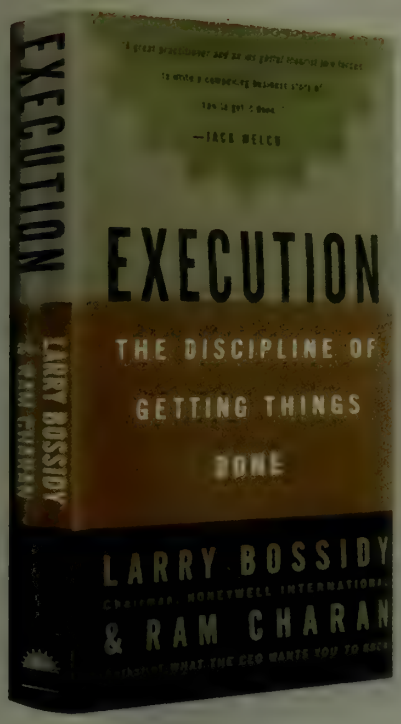
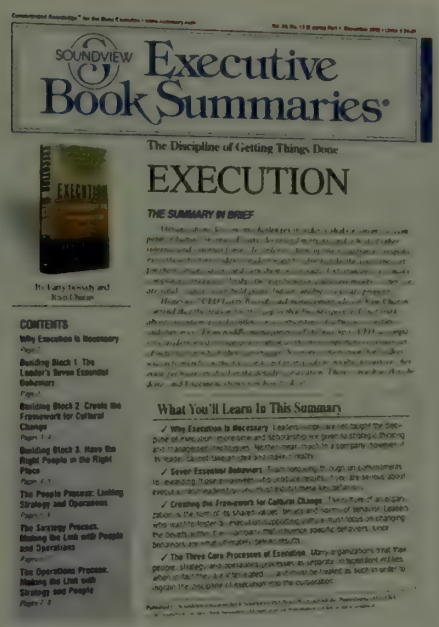
Approximate reading time
3 hours, 30 minutes



Approximate reading time
30 minutes



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BY GENE G. MARCIAL

FULL CARGO HOLDS ARE LIFTING EXPEDITORS INTERNATIONAL.

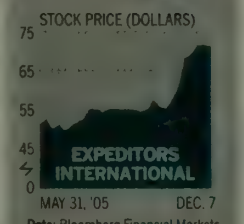
ACACIA GOES AFTER INTELLECTUAL PROPERTY TRESPASSERS.

A SCHERING DEAL GIVES SONUS PHARMACEUTICALS A BIG BOOST.

xpeditors Climbs Fast

XPEDITORS INTERNATIONAL of Washington (EXPD) sounds like a lobby group. But it's a money-making Seattle freight forwarder and customs broker whose ock rose from 50 in May to 71 on Dec. 7. Jonathan Ferrell of p Flight Fund, which started buying October at 55, says: "Expeditors ores well in most measures we ack—such as upside earnings rprises and effective use of assets." ven though it's trading at 36 times 006 estimated profits, the stock ows strong momentum, he notes. he earnings surprises have spurred alysts to hike estimates for 2006 and 007. Expeditors—which gets 40% of s revenues from the U.S., 28% from sia, 18% from Europe, and 14% from e Middle East, Australia, and Latin America—has posted olid margins, thanks to robust world trade. Air freight kicks 39% of revenues, and ocean freight 26%. Expeditors buys pace on planes and ships and resells it to clients. It also gets ommissions for customs brokerage, insurance, and arehousing. Traffic on the Asia-to-North America route has een especially brisk, says Edward Wolfe of Bear Stearns, hich has done business with Expeditors. Wolfe, who rates e stock "outperform," expects Expeditors to earn $1.73 a hare in 2005, $1.95 in 2006, and $2.34 in 2007.

A STEEP ASCENT

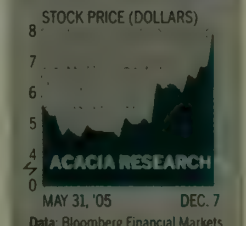


Data: Bloomberg Financial Markets

ow the BlackBerry Flap Helps Acacia

LICENSING PATENTED intellectual property is big business. A suit that NTP filed against Research In Motion, which threatens to shut down its BlackBerry perations, highlights the importance of tech licensing. That as drawn investor attention to Acacia Technologies (ACTG), hich teams up with small outfits that own patented echnologies and helps license them. It has filed suits against ompanies it believes infringe on those patents, including uch biggies as Comcast and Cox Communications. On Dec. , Matsushita Electric Industrial settled an infringement suit hat Acacia filed covering its audio-video-enhancement echnology used in flat-panel display TV. Last year, Sony also ettled with Acacia. "Our bigger patent suits are against able- and satellite-TV companies covering digital media, mainly video-on-demand," says CEO Paul Ryan. Acacia, he says, has licensed 300 cable-TV and Internet companies, including Walt Disney and Bloomberg. A key court ruling on the digital media suit is expected to come down soon, "and if it's favorable, as I expect, cable outfits may be forced to settle and sign licensing pacts with Acacia," says investment adviser Paul Haber of Leeb Group. Haber says that, even before any settlement, Acacia will turn profitable in 2006 on revenues of $50 million to $60 million. Its stock is up from 4.50 in July to 7.83. Acacia was featured in this column in April when it was at 5.50. Comcast declined comment, and Cox did not return calls.

FAVORABLE RESULTS

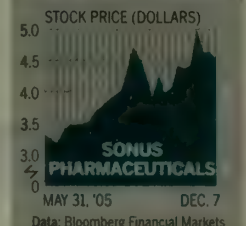


Data: Bloomberg Financial Markets

A German Feather In Sonus' Cap

INSTITUTIONAL INVESTORS weren't privy to what tiny biotech Sonus Pharmaceuticals (SNUS) was up to, but Schering AG knew—and acted. In October the German giant acquired a 15% stake in Sonus and gained a global, exclusive license for Sonus' breast-cancer treatment TOCOSOL paclitaxel—valued at $220 million in licensing fees, royalties, and milestone payments from Schering. That's a big vote of confidence in Sonus, which has no sales yet, says Mark Lappe of Efficacy Capital. He figures TOCOSOL, seen as a replacement for Taxol, will have a potential $1 billion in sales in six or seven years. It is now in Phase 3 trials. He sees the stock at 12 in a year. Also bullish is Mark Monane of investment bank Needham, which has done banking for Sonus. He says TOCOSOL has advantages over Taxol, offering superior safety while allowing delivery of a greater dose density and greater efficacy. He sees Sonus in the black by 2009—earning 36¢ a share, and 77¢ in 2010. It trades at 4.56. ■

THE MEDICINE IS WORKING



Data: Bloomberg Financial Markets

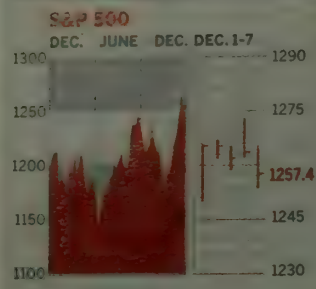
BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

PHOTOGRAPH BY ETHAN HILL; CHARTS BY ERIC HOFFMANN/BW

Personal Business Figures of the Week

STOCKS



COMMENTARY

Stocks began the week on an upbeat note after the Commerce Dept. reported a key inflation gauge had risen at the slowest rate in a year. But wintry weather in the Northeast sent crude oil prices higher and stocks lower. After the market closed on Dec. 7, Texas Instruments announced that next quarter sales would be at the top end of forecasts, a sign of good things to come.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	DEC. 7	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1257.4	0.6	1.6	6.8
Dow Jones Industrials	10,810.9	0.0	0.3	3.5
NASDAQ Composite	2252.0	0.9	3.5	6.5
S&P MidCap 400	738.9	0.7	11.4	16.6
S&P SmallCap 600	357.1	0.8	8.6	13.1
DJ Wilshire 5000	12,581.1	0.7	5.3	8.8
SECTORS				
BusinessWeek 50*	761.2	1.5	8.0	11.2
BW Info Tech 100**	385.8	1.1	3.4	5.3
S&P/BARRA Growth	602.4	0.7	3.5	6.1
S&P/BARRA Value	650.5	0.6	4.0	7.6
S&P Energy	383.9	3.5	33.0	37.3
S&P Financials	424.3	-0.4	1.2	6.6
S&P REIT	153.8	-0.7	6.4	9.0
S&P Transportation	245.4	-0.8	1.6	3.2
S&P Utilities	157.7	-0.4	11.4	15.6
GSTI Internet	210.1	1.1	17.9	25.5
PSE Technology	852.1	1.5	9.5	11.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	DEC 7	WEEK	% CHANGE YEAR TO DATE	% CHANGE LA MO
S&P Euro Plus (U.S. Dollar)	1475.3	1.7	5.6	
London (FT-SE 100)	5528.8	1.9	14.8	
Paris (CAC 40)	4660.6	2.0	22.0	2
Frankfurt (DAX)	5266.8	1.4	23.7	2
Tokyo (NIKKEI 225)	15,484.7	4.1	34.8	4
Hong Kong (Hang Seng)	15,135.0	1.3	6.4	
Toronto (S&P/TSX Composite)	11,131.4	2.8	20.4	2
Mexico City (IPC)	17,244.2	2.5	33.5	4

FUNDAMENTALS	DEC 6	WEEK AGO	YEA
S&P 500 Dividend Yield	1.80%	1.81%	1.9
S&P 500 P/E Ratio (Trailing 12 mos.)	18.5	18.5	19.5
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.1	16.
First Call Earnings Revision*	-1.83%	-1.99%	-0.2

*First Call

TECHNICAL INDICATORS	DEC 6	WEEK AGO	REA
S&P 500 200-day average	1205.8	1204.3	Positi
Stocks above 200-day average	63.0%	60.0%	Neutr
Options: Put/call ratio	0.74	0.69	Positi
Insiders: Vickers NYSE Sell/buy ratio	3.24	3.13	Negati

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Paper Products	21.9	Oil & Gas Refining	92.7
Fertilizers & Ag. Chems.	20.9	Oil & Gas Drilling	65.6
Steel	16.2	Oil & Gas Exploration	65.5
Gold Mining	15.3	Fertilizers & Ag. Chems.	60.9
Home Furnishings	14.4	Divsfd. Metals & Mining	60.9

WORST-PERFORMING GROUPS	LAST MONTH %		LAST MONT
Automobiles	-8.6	IT Consulting	-4
Genl. Merchandise Chains	-6.8	Automobiles	-4
Home Entertainment	-5.6	Photographic Products	-2
Personal Products	-3.3	Auto Parts & Equip.	-2
Parts Distributors	-2.8	Internet Retailers	-2

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED DEC. 6

52-WEEK TOTAL RETURN

WEEK ENDED DEC. 6

Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	13.8	Latin America	73.6
Latin America	10.6	Natural Resources	48.7
Diversified Emerg. Mkts.	7.7	Diversified Emerg. Mkts.	36.3
Natural Resources	7.0	Japan	32.4
LAGGARDS		**LAGGARDS**	
Health	2.3	Domestic Hybrid	5.5
Domestic Hybrid	2.4	Miscellaneous	8.7
Utilities	2.7	Technology	9.2
International Hybrid	2.8	Large-cap Blend	9.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Ultra Japan Inv.	23.5	ProFunds Ultra Japan Inv.	102.7
ProFunds Precs. Mtls. Inv..	18.3	T. Rowe Price Lat. Am.	80.9
Fidelity Select Gold	16.3	iShares MSCI Brazil Idx.	78.5
Midas	15.5	iShares S&P L. Am. 40 Idx.	77.3
LAGGARDS		**LAGGARDS**	
Ameritor Investment	-11.1	Ameritor Investment	-63.6
Potomac Sm. Cap/Sh. Inv.	-9.2	American Heritage Grth.	-42.9
ProFds. USh. Sm. Cap Inv.	-8.9	ProFds. USh. Mid Cap Inv.	-27.5
Rydex Dyn. Vent. 100 H	-8.0	Frontier MicroCap	-20.8

INTEREST RATES

KEY RATES	DEC 7	WEEK AGO	YEAR A
Money Market Funds	3.57%	3.59%	1.56
90-Day Treasury Bills	4.01	3.94	2.25
2-Year Treasury Notes	4.40	4.41	2.94
10-Year Treasury Notes	4.51	4.49	4.22
30-Year Treasury Bonds	4.71	4.69	4.89
30-Year Fixed Mortgage †	6.24	6.19	5.76

†BanxQuote, Inc

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.92%	4.53%
Taxable Equivalent	5.60	6.47
Insured Revenue Bonds	4.05	4.58
Taxable Equivalent	5.79	6.54

THE WEEK AHEAD

RETAIL SALES *Tuesday, Dec. 13, 8:30 a.m. EST* » Retail sales are forecast to have grown 0.5% in November, after soft vehicle sales led to a 0.1% dip in the prior month. That's the median forecast of economists surveyed by Action Economics. Less autos, November sales likely rose 0.1%, following a 0.9% jump in October.

FOMC MEETING *Tuesday, Dec. 13, 9 a.m. EST* » The Federal Reserve's Open Market Committee meets to set monetary policy. Every economist expects the central bank to raise the Fed funds to 4.25%, from 4%.

INTERNATIONAL TRADE *Wednesday, Dec. 14, 8:30 a.m. EST* » The foreign trade deficit probably hit $64 billion in October. In September, the trade gap set a new monthly record of $66.1 billion.

CONSUMER PRICE INDEX *Thursday, Dec. 15, 8:30 a.m. EST* » Consumer prices for goods and services most likely fell 0.1% in November. Less food and energy, core prices probably rose 0.2%. Both the headline and core indexes climbed 0.2% in October.

INDUSTRIAL PRODUCTION *Thursday, Dec. 15, 9:15 a.m. EST* » November factory output probably expanded by 0.4%, after a 0.9% rise in the prior month. The average monthly operating rate most likely edged up to 79.6%.

The *BusinessWeek* production index rose to 263.6 for the week ended Nov. 26, a 13.8% increase from the previous year. Before calculation of the four-week moving average, the index improved to 265.9.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit **www.businessweek.com/extras**

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The Best of 2005's Bunch

Christmas season is upon us again, and with it, a host of Hollywood movie tie-ins, from the freebie King Kong masks at Burger King to *The Chronicles of Narnia* toothbrushes from Oral-B. Sometimes it's a bit much—enough to make you wish for the simpler days of, say, *Snow White and the Seven Dwarfs*. But according to Edward Jay Epstein, that animated flick was a pretty far-reaching business proposition right from the get-go—it was the first movie to have its own tie-in merchandise and soundtrack album. The *Snow White* model, first engineered by Walt Disney Co. in 1937, has come to define Tinseltown's business, in which ancillaries are often key to profits.

With its meticulous documentation of the evolution of the modern global media giants, Epstein's **The Big Picture: The New Logic of Money and Power in Hollywood** (Random House) is one of the top 10 business books of 2005 as selected by *BusinessWeek* reviewers. Focusing on the "sexopoly"—Viacom, Fox, NBC Universal, Time Warner, Sony, and Disney—the author digs deep into Hollywood financial schemes. Reviewer Tom Lowry called *The Big Picture* "a fine adventure" for anyone who's a film buff.

A book that seems ripe for movie adaptation is **Conspiracy of Fools: A True Story** (Broadway Books). *The New York Times* investigative reporter Kurt Eichenwald offers readers a fastidiously detailed, you-are-there narrative of the Enron meltdown that "brings this Byzantine saga to life as never before," in the words of reviewer Wendy Zellner. We are present in ex-CEO Jeffrey Skilling's bedroom as he struggles with the news of his best friend's suicide and in then-Chairman Kenneth Lay's office as he prays over the phone with a bankruptcy lawyer who is asking Lay to surrender his job. One question: Can the book's reconstructed dialogue truly be accurate? Zellner thought that, given the author's heavy reliance on documents fleshed out with more than a thousand hours of interviews, Eichenwald "has likely come as close to reality as any outsider can get."

Another boardroom exposé is *The New Yorker* contributing editor James B. Stewart's **DisneyWar** (Simon & Schuster), an impressively researched account of CEO Michael Eisner's rise and fall and the near destruction of an American institution. Stewart draws upon mountains of documents and a high level of access to Eisner to paint a picture of persistent misjudgments, run-amok egos, and world-class paranoia in the Magic Kingdom. Among Eisner's missteps: the construction of chronically troubled EuroDisney outside of Paris. Eisner's personnel machinations are mind-boggling, including threats to fire longtime partner Frank Wells. The CEO's tyrannical ways finally led in 2004 to an open revolt

Our Top 10*

THE BIG PICTURE *The New Logic of Money and Power in Hollywood* by Edward Jay Epstein

BLINK *The Power of Thinking Without Thinking* by Malcolm Gladwell

CONSPIRACY OF FOOLS *A True Story* by Kurt Eichenwald

DISNEYWAR by James B. Stewart

FAB *The Coming Revolution on Your Desktop—From Personal Computers to Personal Fabrication* by Neil Gershenfeld

FORTUNE'S FORMULA *The Untold Story of the Scientific Betting System That Beat the Casinos and Wall Street* by William Poundstone

THE FUTURE FOR INVESTORS *Why the Tried and True Triumphs Over the Bold and the New* by Jeremy J. Siegel

THREE BILLION NEW CAPITALISTS *The Great Shift of Wealth and Power to the East* by Clyde Prestowitz

WINNING by Jack Welch with Suzy Welch

THE WORLD IS FLAT *A Brief History of the Twenty-First Century* by Thomas L. Friedman

*In alphabetical order by title

Why is he so attracted?

Roberto Gradnik
Regional Vice-President, Serono

Italy is currently a key strategic location for Serono, thanks to its competitive costs, excellent research centres and high productivity, comparable to Switzerland or anywhere in Europe. This is why Serono chose to strengthen its Italian presence with a new R&D centre in Rome in 2004. Italian Life Sciences industry is the third largest in Europe, a world market leader in the sector attracting major global companies. The presence of high performing research centres with a proven track record of achievements in Healthcare research and a strong synergy between academia and industry has led to the creation of specialized biotechnology clusters, with excellent perspectives in Oncology and Neurosciences. An array of recent applications in the Biomedical, Bioinformatics, Biomechanics and Nano-biotechnology fields is catching foreign investors' attention.
Serono is attracted, we bet you are too.

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Invest in Italy

among company directors—and a 45% shareholder vote to remove Eisner.

An equally Darwinian if less squalid view of business can be found in **Winning** by former General Electric Co. CEO Jack Welch with Suzy Welch (HarperBusiness). This advice book focuses on how one can succeed within a company, excel over the course of a career, and help your company prevail against the competition. The authors consider a broad range of topics drawn from questions posed to Welch on the speaking circuit, including how to operate in China's autocratic business culture. Naturally, they expound on Welch's business philosophy, including the need to rate employees on the basis of their performance. One of the most unexpected sections concerns work-life balance. Even here, though, toughness prevails: Flexibility on the job, say the authors, is something you earn via superior performance.

Two books on investing should appeal to would-be Warren Buffetts. Jeremy J. Siegel's **The Future for Investors: Why the Tried and True Triumphs Over the Bold and the New** (Crown Business) itself offers a bold thesis: Putting money into hot tech companies, rapidly expanding sectors of the economy, and fast-growing countries may not be the best way to make money. The key issue, according to the Wharton School finance professor, is the temptation of investors to pursue hot stocks without giving sufficient thought to how much they cost. Crunching data on winning stocks of the past half-century, Siegel offers three portfolio recommendations: a high allocation of international stocks, good dividend yields, and reasonable price-to-earnings valuations.

Oddsmaking is central as well to **Fortune's Formula: The Untold Story of the Scientific Betting System That Beat the Casinos and Wall Street** (Hill & Wang) by William Poundstone. This is the sometimes Runyonesque, sometimes intellectually challenging account of the development of a "surefire" way to win at cards, roulette, and the stock market: the "Kelly criterion," first revealed in 1956 by a young Bell Laboratories physicist named John L. Kelly Jr. The system dictates how much of your money to bet to maximize the growth rate of your wealth while controlling risk. Some of Poundstone's book can be tough sledding for casual readers. But he eases the way with anecdotes about all kinds of characters, from mobsters Al Capone and Longy Zwillman to Nobel prize-winning economist Paul A. Samuelson.

A different gee-whiz account may be found in **Fab: The Coming Revolution on Your Desktop—From Personal Computers to Personal Fabrication** (Basic Books) by Massachusetts Institute of Technology star physicist Neil Gershenfeld. Imagine "printing" various three-dimensional gadgets, such as cell phones, using only a computer and an ink-jet printer. Such is the promise of so-called fab labs—personal fabrication systems consisting of small, inexpensive clusters of tools and software. Rather crude versions of such fab labs are in use today in far-flung, remote locations from Ghana to Arctic Norway. In the latter, herders of sheep and reindeer make little radio tags and wireless radio-relay stations to track animals' movements. One big drawback: A fab lab costs abou $20,000. *Fab* is a fascinating book that even nontechnophile will love, found reviewer Otis Port.

Patience is a virtue, right? Not necessarily, says Malcolm Gladwell, a writer for *The New Yorker* and author of *The Tipping Point*. In **Blink: The Power of Thinking Without Thinking** (Little, Brown), Gladwell examines the process of snap decision-making and finds it often amazingly on-target. For example, he tells how, in a 2002 U.S. military war game, a "rogue commander" used seat-of-the-pants reasoning to best a phalanx of technology-burdened, process-obsessed opponents. The secret of such abilities, says Gladwell, is "thin-slicing," or instantly homing in on a few key details while ignoring extraneous stuff. The case studies, which include such negative examples as the 1999 New York City police slaying of Amadou Diallo, are engrossing, even if, as reviewer Diane Brady found, the author's advice about how to improve our snap judgments is a bit vague.

Finally, two studies shed scary light on globalization. In **The World Is Flat: A Brief History of the Twenty-First Century** (Farrar, Straus & Giroux), *The New York Times* columnist Thoma L. Friedman often adopts a whistling-past-the-graveyard tone as he considers how the Web and other cutting-edge developments have reshaped industries, economies, and world politics, all in one generation. Friedman takes readers on a tour of innovation centers throughout Asia and America. As he nears the end of his account, though, the author exhibits increasing anxiety. Hal of the world—Africa, Latin America, and rural parts of Indi and China—isn't benefiting at a from globalization, he acknowledges. Meanwhile, in the long run the U.S. may not fare too well, Friedman notes. There's a real possibility that all knowledge-based work will be offshored.

Exposés of Enron and Eisner, scary studies of globalization—the picks delve deep

Clyde Prestowitz compounds our concern with his **Three Billion New Capitalists: The Great Shift of Wealth and Power to the East** (Basic Books). The former Reagan Administration trade negotiator proceeds from the observation that Chinese workers have "a fifteen to thirtyfold advantage" over Americans in the area of labor costs. Prestowitz sees China soaking up global investment unless the U.S. develops a federal industrial policy to nurture certai businesses. He says India, too, is a threat, with its emphasis on such sectors as software, computer services, and medicin The U.S., he thinks, has to up its savings rate and improve secondary education, infrastructure, and worker training. Above all, he says, Americans need to face up to reality. Toward that goal, every one of this year's top books can mak a worthy contribution. ■

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IdeasFaceTime
WITH MARIA BARTIROMO

Red Flags from Bob Rubin

FORMER TREASURY SECRETARY Robert E. Rubin has a long, flowing title at Citigroup: director and chairman of the executive committee; member, office of the chairman. But his real role is strategic thinker. In several discussions over the past weeks, Rubin talked about what he sees on America's horizon.

What are the biggest dangers facing the world economy?
The enormous global imbalances, particularly those focused on the U.S.—the fiscal imbalances, trade imbalances, virtually [nonexistent] personal savings compared with debt. The U.S. is at a critical juncture. [It faces] a competitive challenge of historic dimensions coming from China, India, and many other emerging-market economies. India, China, Korea, and Southeast Asia will be the most robust part of the global economy and will become the center of it over the decades ahead. At some point in that period, China will likely become the world's largest economy. That is a challenge we can meet, but we are not on track to meet it today.

Given the disarray and disruption at the White House, how easy is it going to be to get things done?
The things we most powerfully need to do are difficult politically, and I don't see any movement. The projections of mainstream forecasters haven't changed: $4.5 trillion to $5 trillion of deficit over the next 10 years if the 2001-02 tax cuts are made permanent and if there is [alternative minimum tax] reform.... When you get to the middle of the next decade, the rate of growth of Medicare and Social Security all of a sudden increases rapidly because baby boomer retirements increase dramatically. The federal health-care challenges represent five or six times the problem of Social Security. Meantime, you have competition from emerging markets. Can you get things done? I suppose. But we need a vastly improved education system, basic research...and nothing is being addressed.

SNAPSHOT

A MAN, A STREAM, A FISH I love fly fishing. I love being on the water. Casting a fly rod is an art. **It's a matter of timing** and hand and eye coordination and then being able to **do it under the pressure**...of seeing a fish and casting to that place. When you get on the water...you get very involved in where the fish might be, and you get very engaged with the water—and **all of a sudden** time has passed. You started at 8 a.m., and the next thing you know it's 5 p.m.

What is the worst-case scenario of the deficits?
[The U.S. has been] shielded from the discipline of the market because of the enormous inflows of capital. It may be that we can have good [gross domestic product] growth for many years to come, but the numbers simply don't add up. And when things don't add up, [growth] stops. It's not indefinitely sustainable to have these deficits and imbalanced accounts. If you had enormous savings rates, then maybe. But we don't have enormous savings.

I want to get a sense of what you're involved with at Citi.
Sure. I'll give you a few examples. We did two [in-depth] reviews [of our businesses] at the end of last year...one in fixed income, the other in the consumer business. I was part of both of those. It was [CEO] Chuck [Prince] and me and a few others. Right now we're looking at a possible acquisition abroad. I have no idea whether we'll do it, but a group of us went over it. It involves complicated questions, so they asked me to think it through.

What do you think of Ben Bernanke as Federal Reserve chairman?
Good choice. People who know him quite well hold him in high regard as a student of monetary policy. In a speech at the Fed retreat in Jackson Hole [Wyo.] in August, I said that I thought the next chairman, in addition to being deeply knowledgeable about macroeconomic theory and insightful about reading data, could well need the experience to deal with market disruptions, given the enormous global imbalances we have...and [Bernanke] doesn't have that experience around markets. But he is fortunate because the Fed bank of New York has a long tradition of good capability with respect to markets, so he has a lot of [experience] he can call on.

Would you have taken the job if the President asked you?
[Laughs] He would never have asked me. I was there 6½ years [and have] no interest in going back to Washington. The pressure is constant. Everything you do is in the media fishbowl.

Maria Bartiromo is the host of CNBC's Closing Bell.

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IdeasOutside Shot

BY CRAIG R. BARRETT

A Corporate Science Project

One of the highlights of my year each spring is getting to meet the 40 finalists in the Intel Science Talent Search (Intel STS) competition. Spending time with these high school seniors, I can't help but feel optimistic about the future of American ingenuity. Some of them could one day win Nobel Prizes, Fields Medals, National Medals of Science, and MacArthur Foundation "Genius Grants." They may be teenagers, but the brilliance of their work makes my own PhD dissertation look dim by comparison.

But their achievements don't tell the whole story about U.S. education. Sadly, the Intel STS finalists are the exception, not the rule. In fact, American K-12 students are consistently outperformed by their foreign counterparts on international math and science assessments. And we have a graduation gap: While the number of jobs requiring technical skills is increasing, fewer U.S. students are entering—and graduating from—degree programs in science, math, and engineering.

Why does this matter? Science and technology are the engines of economic growth and national security in the U.S., and we are no longer producing enough qualified graduates to keep up with the demand. These graduates—like the Intel STS students—represent a resource vital to American competitiveness. It's a resource that is eroding at home even as it's being produced more rapidly and efficiently abroad.

For the past three decades about one-third of U.S. bachelor's degrees have been in science and engineering (the figure includes majors in the social sciences and psychology). Asian nations far outstrip that figure, with China at 59% in 2001, South Korea at 46% in 2000, and Japan at 66% in 2001. Of those degrees, the number awarded in engineering also varied greatly: In China, engineering accounted for 65% of all science and engineering degrees; in South Korea, 58%; and in Japan, 29%. In the U.S., that figure is less than 5%.

HOW DID WE GET HERE? A report released earlier this year by Achieve, a nonprofit organization that helps states raise academic standards, contends that we have institutionalized low performance through low expectations. Our high schools expect only a small number of students to take advanced math and science courses like upper-level algebra and geometry. Another Achieve study showed that much of the math content on state high school exit exams is basic at best, similar to material covered by many foreign students in the eighth grade.

That's particularly troubling because America's economic future lies in its next generation of workers and their ability to develop innovative technologies and products. This means we must strengthen math and science education in the U.S.

We must increase the number of students who can compete on a global level by, for example, committing to a goal to double the number of engineering graduates each year to more than 100,000. Many members of the National Governors Assn. have committed to significantly raising standards in high schools. But they can't do it alone. We in the business community can and should become involved. For example, companies can promote employee volunteerism, sending their best employees out into the schools to excite students about technical careers and encourage them in their studies. They can create scholarships or contribute to existing programs or professional associations that help students pursuing technical degrees. Or they can get involved with various industry/educator consortia working to increase the number of science, technology, engineering, and math majors.

U.S. business needs to help turn out more math and science grads if it is to stay competitive

At Intel, we've made the commitment to improving American education a top priority. We invest about $100 million a year in education programs—some $1 billion to date. These include the Intel Teach to the Future program, which has trained 3 million teachers in 36 countries to integrate technology with learning; support for more than 100 Intel Computer Clubhouses in underserved communities worldwide, giving thousands of children a safe place to explore technology and pursue their dreams; and the Intel STS and Intel International Science & Engineering Fair, which offer thousands of students a forum to showcase their talents.

More U.S. businesses must get involved—not just because it's the right thing to do, but because it will improve their bottom line, and the nation's, by creating a deeper pool of qualified talent at home.

CRAIG R. BARRETT *is Chairman of Intel Corp. and a board member of Achieve.*

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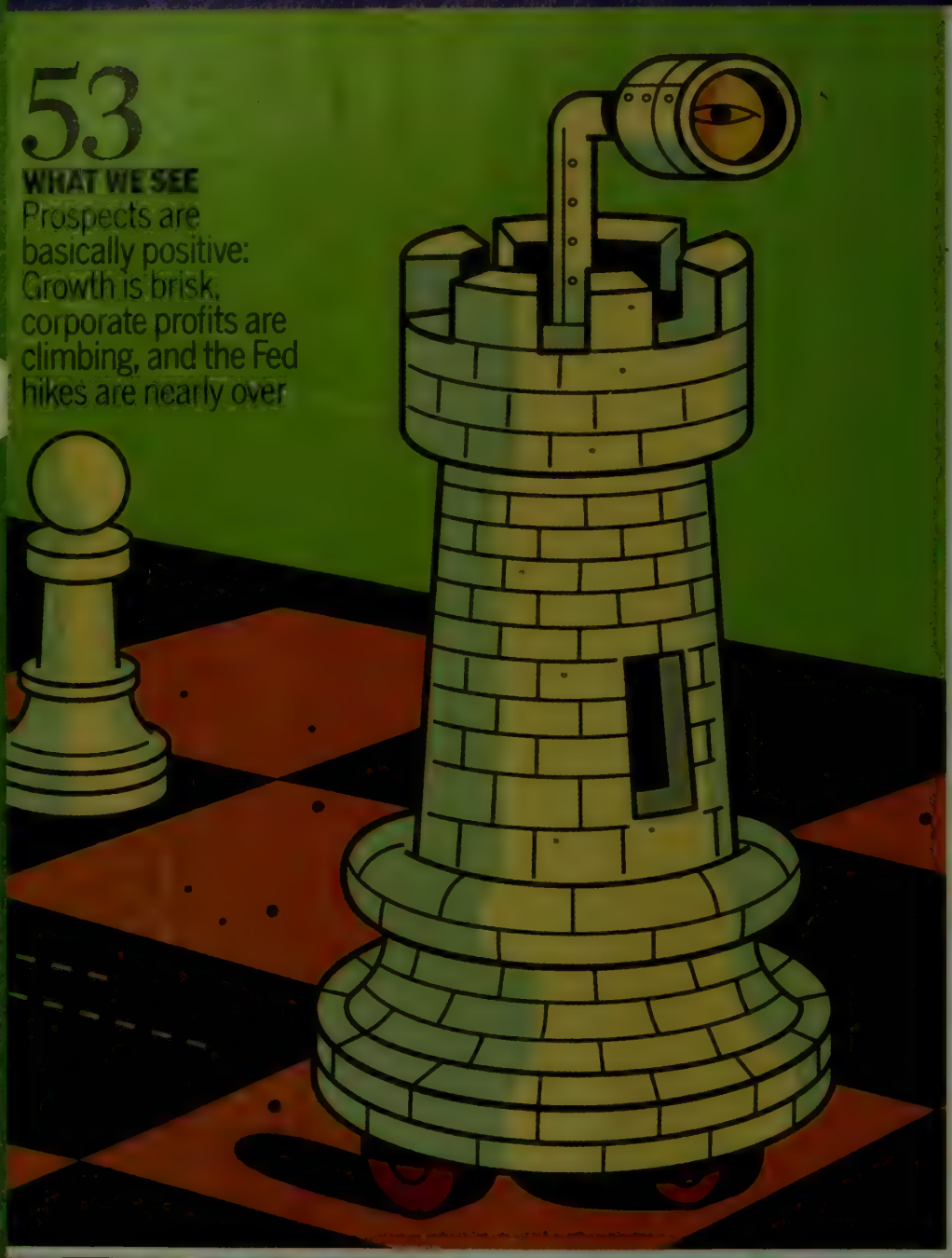

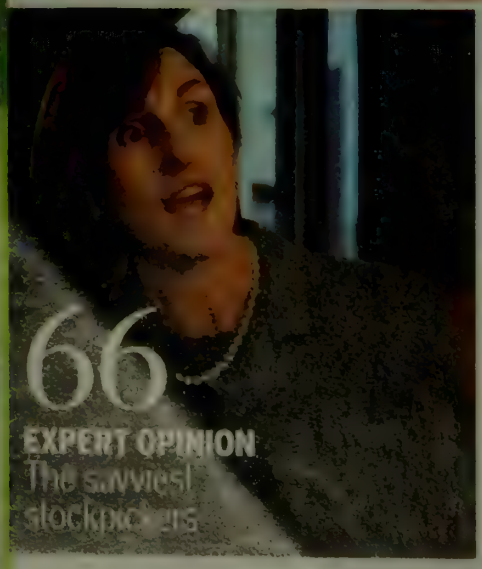

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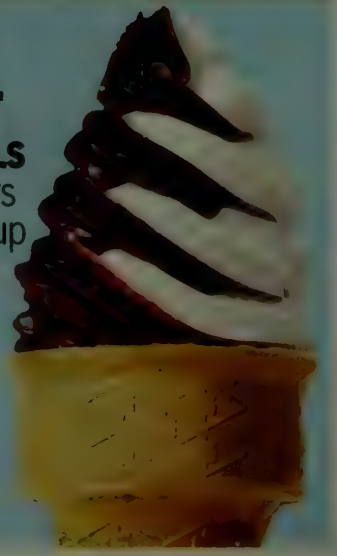

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Technology Special Report: Next-Generation Computers

It has been a long time coming, but finally a **new breed** of computer hardware startups that promise much lower costs is trying to break into the market. This Special Report also examines the rapid growth of **"blade" servers,** how **supercomputers** are becoming even faster, and more. Plus, two slide shows: One profiles the new **hardware pioneers,** the other peeks into the **future of tech**

Why Coca-Cola Has Some Real Problems

Coke is pinning its hopes on new ads, juiced-up old lines, and a few fresh products. BW's Dean Foust examines the strategy, and asks, with its $5 billion in cash, why doesn't Coke copy PepsiCo's success and make acquisitions?

Hasbro Is Playing Nice With Tweens

The No. 2 toymaker is making inroads with the hard-to-please 8-to-12 set. Plus: A **slide show** of hot electronic toys for tweens that are helping Hasbro outperform the industry

A Vote of Confidence In Wikipedia

A study by the journal *Nature* finds that the online encyclopedia is nearly as accurate as *Britannica*—and is widely used by scientists. Plus: A Q&A with Wikipedia founder Jimmy Wales

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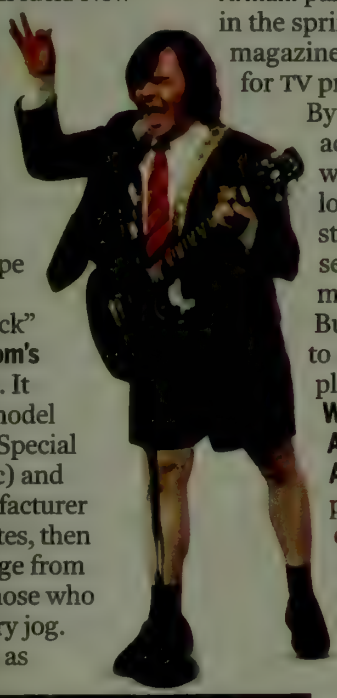
"It will become an expectation like electricity or phone service."
–Craig Mathias of Farpoint Group, about big cities providing municipal Wi-Fi soon, to CNET

EDITED BY DAN BEUCKE

BUY LINES

FINDING THOSE PRODUCTS THAT WERE PLACED

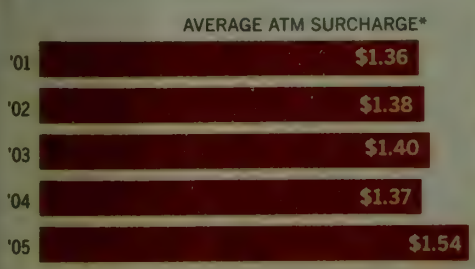
CRAZY ABOUT THE GUITAR Jack Black strummed in *School of Rock*? You're in luck. New Web services make it easier than ever for shoppers to track down products they saw placed in films and TV shows. Just type "guitar" or "School of Rock" into **eVisure.com's** search engine. It supplies the model (a Gibson SG Special Faded Electric) and links to manufacturer and vendor sites, then shows an image from the film, for those who need a memory jog. E-tailers such as **Amazon.com** and **Bang & Olufsen** pay commissions to eVisure.



Broadcasters are jumping in, too. ABC's online store sells apparel worn by *Desperate Housewives* characters (Edie's **Dolce & Gabbana** pumps, Lynette's **Armani** pants). And coming in the spring is *GET* magazine, a kind of *Lucky* for TV product placement. By letting companies advertise products without flashing logos or disrupting storylines, the services may lead to more subtle plugs. But they're not likely to stamp out complaints from the **Writers Guild of America** and **Screen Actors Guild** that placements blur the distinction between advertising and entertainment.
–Elizabeth Woyke

THE BIG PICTURE

FEE FOR ALL Americans will pay an estimated $4.3 billion to withdraw cash from ATMs this year as fees hit an all-time high.



*FEES FOR THOSE NOT HOLDING AN ACCOUNT WITH THE ATM BANK
Data: Bankrate.com, from its November survey

TAKING STOCK

The Nikkei: Room to Run?

FAST MONEY. BLOATED TRADING VOLUMES. Soaring prices. Has Japan's stock market returned to the roaring '80s? U.S. investors apparently think so. The "Buy Japan" cry from funds and stockpicking newsletters is downright deafening. Foreigners have spent more than $78 billion on Japanese stocks this year, a wave of capital not seen since 1999. The Nikkei 225 index hit a five-year high of 15,778 on Dec. 13, up 37% year-to-date.

But a bit of caution may be in order. Japanese stocks sport p-e ratios of 26 times forecast 2006 earnings, vs. 16.5 for the S&P 500. On Dec. 9, **Credit Suisse First Boston** urged clients to cut their Japan weighting, citing lofty valuations that suggest the market is overbought. To be sure, Japan's turnaround is real: Banks have shed most of their bad debt, and the Bank of Japan is unlikely to boost interest rates prematurely, as it did in 2000. But Japan Inc. is still wound up in red tape and burdened with high fixed costs. Japanese companies have burned off a lot of excess debt and capacity, but they're still behind rivals in the U.S. and Europe. And their profit growth is slowing. If foreign money dries up, this rally could end as painfully as earlier ones. *–Brian Bremner and Roben Farzad*

REALITY CHECK

THE 10 WORST ECONOMIC PREDICTIONS ABOUT 2005

As the year of Katrina, Google, and $70 oil draws to a quiet (we hope) close, let's stop to reflect on the biggest forecasting misses. Here are our picks in reverse order:

10. "If Microsoft gets serious about search—and there is every reason to believe that it will—Google will need brilliant strategy and flawless execution simply to survive."

—Charles H. Ferguson, author, Technology Review, Jan. 1, 2005

»REALITY: Google didn't just survive in 2005. It ruled. In the most recent quarter, profits soared 633%, and revenues almost doubled. Microsoft? Profits gained 24%, revenue rose 6%.

9. "The big, big story of 2005 could be the collapse of the dollar."

—Peter Schiff, founder of Euro Pacific Capital in Newport Beach, Calif., Jan. 2, 2005

»REALITY: Collapse? The dollar surged 14% against the Japanese yen and 13% against the euro from the start of the year through mid-December.

8. Chinese Internet stock NetEase.com—"organic and innovative"—will outperform the market.

—Richard Ji, Jenny Wu, and Mary Meeker, Morgan Stanley tech analysts, initiating coverage on Sept. 12, 2005

REALITY: In the first three months after Meeker's team recommended NetEase, the company's shares fell 25%. Oops.

7. Calpine, the big electricity generator, "is making progress with a big financial restructuring. If they just liquidated the company, you'd get $6 a share."

—David J. Williams, portfolio manager of the Excelsior Value & Restructuring Fund at U.S. Trust, Dec. 27, 2004

»REALITY: Calpine's shares were trading around $3.50 when Williams made them one of his top picks for 2005. They're trading now for 31¢—down 91%.

6. Overproduction by OPEC could cause a steep decline in oil prices: "We are concerned about the future. We are concerned about a new severe drop in price like we have witnessed in recent days."

—Iranian Minister of Petroleum Bijan Zanganeh, Nov. 22, 2004

»REALITY: Oil prices were about $50 a barrel when Zanganeh fretted about a severe drop. They hit a record of $70 a barrel in the summer before easing back to "only" around $60 by yearend.

5. Sales of gold by central banks could seal its fate as an economic relic of the Old World. "The pillars of the market are crumbling."

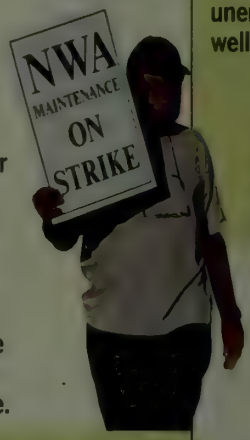
—Andy Smith, a gold analyst at Mitsui Global Precious Metals in London, May 3, 2004

»REALITY: Those golden pillars didn't crumble in 2005. They turned into rocket boosters. Gold rose 16% to a 22-year high in mid-December.

4. Mechanics at Northwest Airlines will win a strike because other workers will stand up for them. "We know we're not in this alone."

—Ted Ludwig, president of Local 33, Aircraft Mechanics Fraternal Assn., Aug. 9, 2005

»REALITY: Northwest had little trouble finding replacements for the 4,100 strikers, and no other unions honored their picket line. The continuing strike is considered a near-total failure.



3. The Dow Jones industrial average will finish 2005 at 8,000 points.

—Bernie Schaeffer, Schaeffer's Investment Research, Dec. 27, 2004

»REALITY: Technically speaking, this prediction could still come true, but it would require the Dow industrials to plummet 26% in the next two weeks. Anyone willing to predict that?

2. 2005 will be "a year of economic difficulty."

—A majority of the American people 54% of respondents to a Gallup poll, Dec. 17-19, 2004

»REALITY: For many, it was a difficult year. But the unemployment rate is just 5%, well below its 30-year average. The economy is growing rapidly. And household wealth is at an all-time high. If 2005 was "difficult," then what would you call a recession?

1. The U.S. will have fewer hurricanes in 2005 than in 2004.

—Tropical Meteorology Project of Colorado State University, Dec. 3, 2004

»REALITY: 2005 broke all hurricane records. Including Katrina and Rita, there were 14 Atlantic hurricanes, 7 of them classified as "intense." The Coloradans had predicted six—only three intense. Granted, predicting hurricane season half a year before it warms up is no easy task. But guys, come on.

—Peter Coy

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SPAM WATCH

UGLY E-MAIL IS FAR FROM GONE

Two years ago, Bill Gates confidently predicted that junk e-mail would be "a thing of the past" within two years. Wrong! Today more than half of e-mail sent worldwide is spam—mostly advertising drugs, pornography, and dating services. "Spam continues to be a major plague to businesses and home users," says Carole Theriault, a senior consultant for security firm Sophos. In fact, brace yourself for a really nasty deluge. Security experts expect a global e-mail blitz of Nazi propaganda on Jan. 6. They believe the Sober-Z virus, which has been attacking PCs worldwide for months, left many open to send pro-Nazi spam.

Microsoft says it has no cause to be embarrassed by Gates's prediction. "It was a call to action for us and the industry," says Ryan Hamlin, general manager for technology care and safety. Since then, software makers have launched anti-spam products, and Microsoft has built defenses into its Outlook e-mail software. Now if PC owners would just use them—or, better yet, stop buying from spammers. *Steve Hamm*

AT THE OFFICE

YOU HAVE 20 MINUTES TO SURF. GO.

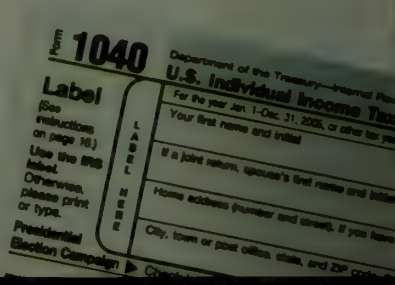
IT'S GETTING HARDER than ever to wheedle a raise out of the boss. So maybe at this year's annual review you should ask for more Web browsing time instead. Several employers are turning to a software program from **Websense** in San Diego that puts workers on the clock for their personal Net use. **Kozy Shack Enterprises**, a Hicksville (N.Y.) maker of ready-to-eat pudding, uses the "quota time" feature in Websense Enterprise to give employees one hour each day to shop, chat, and otherwise browse.

Info-tech managers can choose what sites are available during that time and adjust access depending on job titles. "We have sales people who travel extensively, so we give them much more access to travel sites," says Kozy's IT director, Richard Lehan. At **Bates County Memorial Hospital** in Butler, Mo., staff get 20 minutes a day for personal Internet use; department managers get 40.

For some companies, that's just too Big Brother-esque. Employees at London-based high-end retailer **Harvey Nichols** sign an honor code stating that personal Web use will be limited to their lunch break or after hours. The chain uses Websense to block gambling, pornography, and other inappropriate sites, but it doesn't limit time. "We have quite a bit of trust in people in the company," says Lee Smith, technology business systems manager. And most tech outfits figure they can't be Web innovators while restricting its use. Says **Microsoft** spokesman Lou Gellos: "We expect all employees to exercise common sense and good judgment and shop on MSN shopping—and I say that kind of tongue in cheek."

–Lindsey Gerdes

TO HOLD DOWN budget deficits while enacting President George W. Bush's tax cuts, Congress set scores of popular breaks to gradually phase out. Here is a look at when a few will disappear and what it would cost to continue them for an extra five years.



		WHAT HAPPENED	EXPIRES	COST TO EXTEND
INDIVIDUALS	ALTERNATIVE MINIMUM TAX EXEMPTION	If a special income exemption is allowed to drop, the AMT will trap an additional 30 million taxpayers by 2010.	12/31/05	$175 BILLION
INDIVIDUALS	STATE AND LOCAL SALES TAXES	You could write these off until 1986, then you couldn't, then you could	12/31/05	10 BILLION
INDIVIDUALS	CAPITAL GAINS AND DIVIDENDS	Rates were cut to 15% in 2003, but they're set to rise again	12/31/08	100 BILLION
BUSINESS	RESEARCH AND EXPERIMENTATION	Known as the R&D credit, it's a boon to drug companies and tech outfits	12/31/05	27 BILLION
BUSINESS	FOREIGN EARNINGS	Companies can bring home foreign earnings and pay a tax rate of just 5.25%	10/20/06	22 BILLION
BUSINESS	COMPUTER WRITE-OFFS	Small biz can write off the full cost of computer equipment, up to $105,000	12/31/07	15 BILLION

Data: Congressional Budget Office

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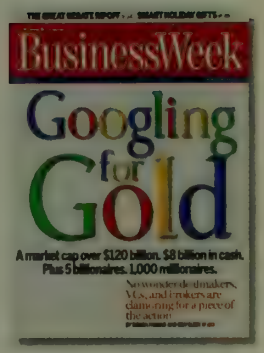
> "Many venture capitalists are simply lucky imbeciles hiring other lucky imbeciles to run most of the Valley companies."
>
> *–Frank Petkovich*
> *San Francisco*



ALL AGOG OVER GOOGLE

"GOOGLING FOR GOLD" (Cover Story, Dec. 5) had me giggling with glee. Venture capitalists bypassed! Could it be that Googlers find the meat (engineers and techies) tastier than the sauce? On top of that, treating the "business types" like second-class citizens—what an outrage! Is it possible the engineers and techies can run a business as well as or better? Maybe we will have to declare business types a special interest group and install an affirmative-action program to stop this disgraceful prejudice!

–Ken Grieshaber
Bethlehem, Pa.

I WAS TICKLED AND unnerved by the comments made by Silicon Valley venture capitalists regarding Google Inc. When one berated the Google "punks" complaining about the food and drink, and another discussed Google's "height of arrogance" in having VCs complete information spreadsheets, it's simply a case of "turnabout is fair play." In my eight years with three VC-funded startups, I have found that many VCs are simply lucky imbeciles hiring other lucky imbeciles to run most of the Valley companies. Google is on to their games.

–Frank Petkovich
San Francisco

YOUR ARTICLE MUST set some sort of record for wretched excess. It is as if the La-La Land of the 1990s bubble never happened.

–John Endean
President
American Business Conference
Washington

MY WIFE AND I are Google investors, so the article provided a thought-provoking new context to its corporate culture and strategic planning. The piece did nothing to allay my concerns about the Google tag line, "Don't be evil." Why did Messrs. [Larry] Page and [Sergey] Brin not choose to coin a more positive phrase, such as "Be good" or "Do right"?

–Jim Rowbotham
New York

A GREAT DEBATE ABOUT REBATES

IN "THE GREAT REBATE runaround" (News: Analysis & Commentary, Dec. 5)

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CORRECTIONS & CLARIFICATIONS

In "Funds made to deliver" (Personal Business, Dec. 12), the Absolute Strategies Fund was misidentified as the Absolute Return Strategies Fund.

"Best leaders" (Cover Story, Dec. 19) misstated the age of Apple Computer CEO Steve Jobs. He is 50.

ou were far too kind toward rebate pro-
oters. Rebates have all the characteris-
cs of a classic scam, where the mark
ictim) is made to pay money up front
on the promise of getting it back later.
e should perhaps give credit to much-
aligned Wal-Mart for refusing to stoop
using rebates.

–Claude Y. Paquin
Fayetteville, Ga.

OU MENTIONED STAPLES as a compa-
y trying to do better, but Costco Whole-
le's program should be called out as a
odel for everyone, as they avoid pitting
e retailer against the manufacturer. You
y it at Costco, and Costco sends you the
bate. You simply go online and confirm the information contained on your receipt. The entire process takes less than 10 minutes, and you have your check in two weeks.

–Craig A. Vickers
Fairfield, Calif.

HAVING DELIVERED MAIL for 25 years and also received quite a few rebates myself, I know what rebate checks look like. In my experience rebate checks have more addressing errors than any other kind of mail I deliver. You warn that rebate checks look like junk mail. Most of the time they are junk mail, meaning that they are discarded if not deliverable.

–Bob Zepernick
Oakland, Calif.

HOW VERIZON PICKS AND CHOOSES

SPENCER ANTE'S ARTICLE ignores a key fact about cable-TV franchises in New York: New York State regulations provide a "fast-track" process that would give Verizon automatic approval to deliver TV service in any municipality in the state in just 30 days if it would simply agree to the same terms as the existing TV provider. Instead, Verizon wants to cut special deals eliminating local control, allowing it to pick and choose which neighborhoods to serve and failing to protect towns and villages from liability. Clearly, the only thing slowing down Verizon is Verizon itself.

–Richard F. Alteri
President & CEO
Cable Telecommunications Association of New York
Albany, N.Y.

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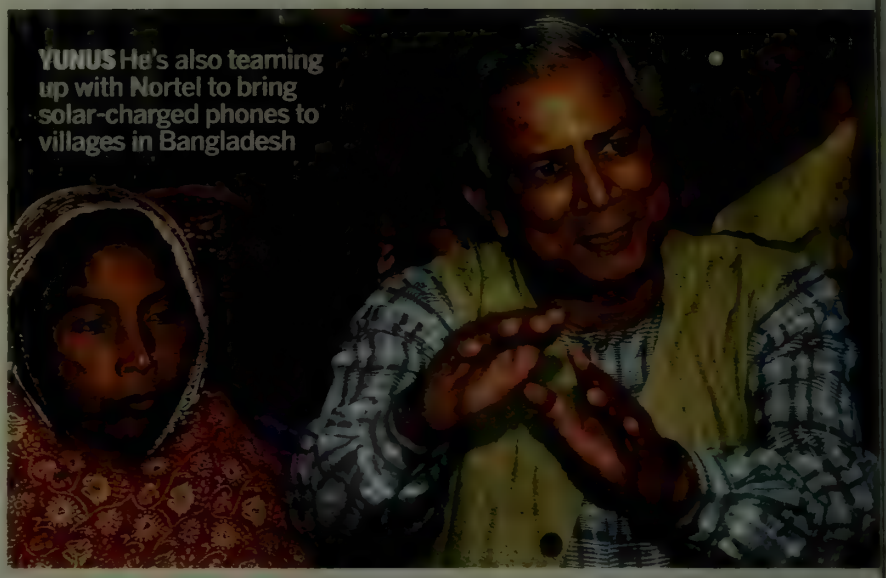
Microcredit Missionary

AS A YOUNG economics professor at Chittagong University in Bangladesh in 1976, Muhammad Yunus lent $27 out of his own pocket to a group of poor craftsmen in the nearby town of Jobra. To boost the impact of that small sum, Yunus volunteered to serve as guarantor on a larger loan from a traditional bank, kindling the idea for a village-based enterprise called the Grameen Project. It never occurred to the professor that his gesture would inspire a whole category of lending and propel him to the top of a powerful financial institution.



YUNUS He's also teaming up with Nortel to bring solar-charged phones to villages in Bangladesh

Today, Yunus runs Bangladesh's Grameen Bank, a leading advocate for the world's poor that has lent more than $5.1 billion to 5.3 million people. The bank is built on Yunus' conviction that poor people can be both reliable borrowers and avid entrepreneurs. It even includes a project called Struggling Members Program that serves 55,000 beggars. Under Yunus, Grameen has spread the idea of microcredit throughout Bangladesh, Southern Asia, and the rest of the developing world.

"At first I didn't think that what I did had any significance in a broader context," he explains. But the mission keeps expanding in scale, and in the meantime, Yunus has grown intimately familiar with the unbearable dimensions of global poverty. As many as 1.2 billion people around the planet lack access to basic necessities, he explains, and microfinance could be their pathway out of despair. "Yunus and Grameen have taken a first step, which has inspired others to take a look at [microfinance] as a business," says John Tucker, deputy director of the microfinance unit at the U.N. Capital Development Fund.

Yunus' innovation has broad appeal. In 1997 only about 7.6 million families had been served by microcredit worldwide, according to the 2005 State of the Microcredit Summit Campaign Report. As of Dec. 31, 2004, some 3,200 microcredit institutions reported reaching more than 92 million clients, according to the report. Almost 73% of them were living in dire poverty at the time of their first loan.

When Yunus started Grameen, he wanted to turn traditional banking on its head. One of his first moves was to focus on women because they are most likely to think of the family's needs. This was a radical step in a traditional Muslim society, and it took Yunus six years to reach his initial goal of a 50-50 gender distribution among borrowers. Today, 96% of Grameen's borrowers are women. "If banks made large loans he made small loans. If banks required paperwork, his loans were for the illiterate. Whatever banks did, he did the opposite," marvels Sam Daley-Harris, director of the Microcredit Summit Campaign. "He's a genius."

Muhammad Yunus wasn't afraid to turn the rules of banking upside down

In some cases, Yunus has been able to attract private capital to fund socially driven businesses. GrameenPhone, a for-profit telecom outfit, is 51% owned by Norway's Nortel Networks Ltd. It works with the not-for-profit Grameen Telecom to provide bulk airtime for so-called village phones. Funded by loans to individual women, these systems—built from simple handsets and solar chargers—function as pay phones in many rural areas. Now the idea of a "village phone lady" is catching on, along with other low-cost, high-tech systems, in other parts of Asia and Africa. An energy enterprise, Grameen Shakti, sells around 1,500 home solar-panel systems per month throughout rural Bangladesh and is growing 15% a year without subsidies, says Yunus.

The professor's most recent innovation is still an experiment: Grameen Danone Food Co. is a proposed partnership between Grameen and France's Group Danone to make a nutritious and inexpensive baby formula. Next on his list are low-cost eye care and rural hospitals with video-conferencing between villagers and doctors in Dhaka. "In Bangladesh, where nothing works and there's no electricity," Yunus says, "microcredit works like clockwork." ■

–By Jeffrey Gangemi

BusinessWeek online For a Q&A with Muhammad Yunus, go to www.businessweek.com/extras

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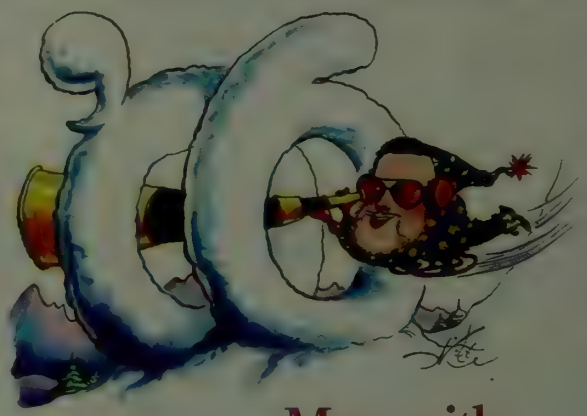
BY STEPHEN H. WILDSTROM

PCs: The Buzz Is Back

Could 2006 be the year that personal computers once again dominate the technology news? PC innovation has been in short supply, and the last really big events came in 2001 when Apple released its OS X operating system and Microsoft followed with Windows XP. Next year promises to bring major changes in both software and hardware.

Apple and Microsoft will again provide the bookends for the year. In January, Apple is expected to unveil the first Macs based on Intel processors. These are likely to include a new generation of mobile chips designed to bring more desktop-like performance to Windows and Mac laptops. And in the fall, Microsoft will release a version of Windows, called Vista, that will bring the first major change in the look and feel of the operating system in a decade. Even without seeing the final product, Microsoft critics already are deriding Vista as just another pretty face. But its real importance lies in security enhancements designed to attack the plague of viruses, worms, and spyware that is crippling computers and damaging consumer confidence in online commerce.



PCs won't upstage the iPod in 2006. Indeed, the advances we'll see in computing all reflect the importance of digital entertainment, which the iPod helped establish. After all, we don't need more powerful computers or new Windows to improve the experience of reading e-mail or writing memos. The power boost is required for a better rich-media experience, especially high-quality video.

Apple also helped set the stage for a leap in Internet-based programming. The buzz became a reality in 2005, especially with Disney's deal to sell TV shows at the iTunes Music Store. Now Yahoo!, America Online, and others are readying their own offerings. But I think video on the Net won't score in the mass market until it becomes easy to watch on your big-screen TV, not just on a PC or an iPod.

THERE ARE STILL LOTS OF PROBLEMS to work out before you can easily download TV-type programming and view it wherever you want. A new Intel platform called Viiv is designed to make this easier by building media-sharing capabilities into standard PC hardware. Viiv will appear in early 2006 on Windows XP Media Center Edition PCs. But by duplicating in hardware the functions of Media Center software, Intel is challenging Microsoft for dominance in the digital living room. The big surprise of 2006 could be an Apple-Intel alliance that brings Viiv capabilities to the new Intel-based Macs. Apple recently added some Media Center-like capabilities to its iMac line with a program called Front Row. It can show videos and photos and play music on a Mac from across a room, using a remote instead of a mouse and keyboard.

Macs with Intel chips and a new Windows will bookend '06

Front Row, however, lacks the Media Center's ability to connect to a home entertainment system and zip music or movies to any room in the house. A partnership could allow Intel to do the technological heavy lifting, while letting Apple apply its incomparable talents for design and ease of use. I can't promise that Apple and Intel will actually get together and build the perfect digital entertainment hub—thus disrupting the info-tech industry, consumer electronics, and the entertainment biz all in one shot. But it could happen.

Even without such a move, the new products from Apple and Microsoft are big deals. An Intel-based Apple will move the Mac toward the computer mainstream while keeping its distinctiveness. As for Vista, even though the most important changes will be under the hood, a system designed from the ground up for secure computing should give us PCs that are not only safer but considerably more reliable.

I want to take this opportunity to thank all of you for your support and wish you the best for a happy, healthy, and secure 2006. And keep those e-mails coming. ■

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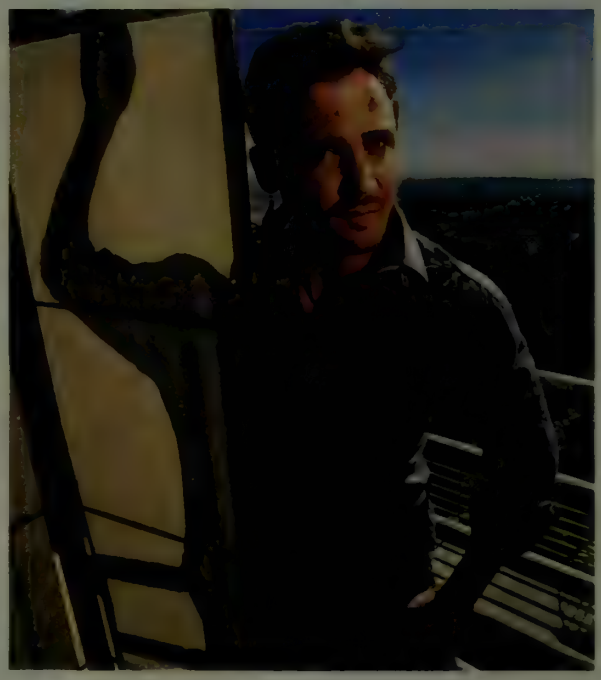
Move Over, MySpace

Is there redemption in cyberspace? That's the question for Brad Greenspan, a 32-year-old Internet entrepreneur who started his first business from his dorm room at the University of California at Los Angeles and helped launch one of the Internet's biggest hits, the wildly popular social networking site MySpace.com (BW—Dec. 12), when he invested in it in 2003. Today he's backing what he bets will be the Next Big Thing: a social network site called Vidilife that is using online videos to lure Net surfers, a sort of MySpace for the video crowd. Traffic has been promising so far: 220,000 unique users in October, six weeks after launch in September, according to Internet ratings agency comScore Media Metrix. That's a far cry from MySpace's 24.3 million unique users but not bad for a site with no marketing. "Can [Greenspan] catch lightning in a bottle twice? Probably not," says John Tinker, senior media analyst at ThinkEquity Partners LLC. "But that's a lot of traffic for a site I didn't know existed."

Greenspan may be on to something, especially now that every kid at a PC can put video online. Web sites like Heavy.com get 10 million users in a month, much of it to see videos made by some amateur Steven Spielberg. The idea isn't so very dissimilar from the instant-community allure of the Internet and what made MySpace so popular. Vidilife may not always be tasteful—lots of videos of girls, some scantily clad—but it's still likely to draw the under-30 singles crowd.



GREENSPAN His new social network site, Vidilife, lures surfers with online videos

VIDILIFE IS MORE THAN JUST A BUSINESS move for Greenspan; he needs it to help restore his street cred as a Net mogul. That's because he never got to celebrate MySpace's huge success. He was forced from the company he founded, eUniverse, only months after he spent $1 million to finance MySpace's launch. Greenspan battled with board members, who changed the company's name to Intermix Media shortly after his departure. Among the disputes: restated earnings during his watch that prompted an informal Securities & Exchange Commission accounting investigation (now closed) and a temporary delisting of its stock by NASDAQ. Separately, both the company and Greenspan settled charges with New York Attorney General Eliot Spitzer in September that they inserted spyware on unknowing consumers' Web pages. Neither admitted guilt.

Greenspan, who concedes he took his eye off operations while eUniverse was expanding, says in a lawsuit that he was forced out by then-eUniverse executives who allied with venture capitalists to protect their own jobs. Intermix called the suit "meritless" in an SEC filing but declined comment to *BusinessWeek*. In addition, Greenspan twice tried to retake his company in proxy battles, including a futile gambit in September to trump a $580 million bid by News Corp. for Intermix. "It definitely was a wild ride, and I learned some lessons," says Greenspan in the lounge at L'Ermitage Hotel, dressed in jeans and a silk shirt and sporting a five-day stubble. He made more than $47 million from the News Corp. acquisition, but a successful launch of a site to rival MySpace could be the ultimate comeback.

Vidilife looks a lot like MySpace, right down to the tool bar that directs users to browse for members, blog, or join a club. And the idea for Vidilife was brought to him, says Greenspan, by an ex-MySpace executive. Down the road, he says, he aims to launch a new site for families and will probably bring in partners with big money to help him expand further. "I don't have any illusions that I can overtake [MySpace]," he says. "I just want to have the best video service I can." Maybe so. But in the sizzling world of social networks, in which technology makes gratification instant, Brad Greenspan could yet have a shot at the redemption he seeks. ■

BusinessWeek online Media Centric columnist Jon Fine is on vacation. For his blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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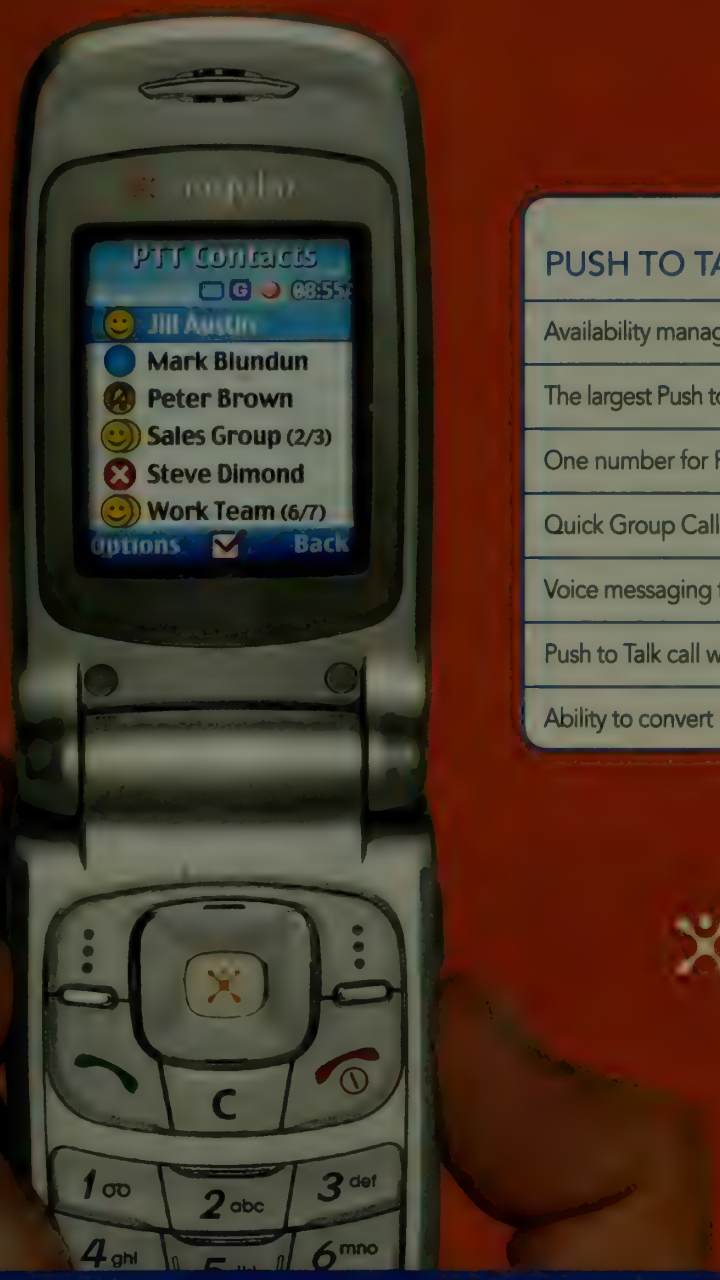

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TheBarkerPortfolio

BY ROBERT BARKER

The IPO Class of 2006

Initial public offerings due in 2006 are shaping up much as they have the past couple of years—a steady stream, with a few biggies in the pipeline. Yet there's a difference: Soon-to-be-public companies now are freer to talk about themselves before a much wider audience. For the first time in decades, this includes you.

On Dec. 1, the Securities & Exchange Commission put into effect a new policy on pre-deal publicity, which was restricted under the Securities Act of 1933. First proposed in 1998, the reforms allow companies preparing to sell securities to speak openly about their businesses and even to broadcast via the Internet the "road show" presentations that in the past have been restricted to institutional investors. In mid-December, I found a dozen or so IPO hopefuls making their pitch at RetailRoadshow.com. This "should have been done years ago," says Linda Killian, principal at Renaissance Capital, the Greenwich (Conn.) firm that runs IPO Plus Fund.

A REFRESHING TRANSPARENCY, YES. Just don't look for every company going public to join in. I contacted several with 2006 IPO plans (table). One told me privately that it had discussed the possibility of podcasting its road show. Yet at spirits maker Castle Brands, President Keith Bellinger said: "The advice from our attorneys is to say nothing." Michael Fox, whose Westport (Conn.) firm, Integrated Corporate Relations, often consults with companies going public, said the prevailing attitude is prudence: "When it comes specifically to talking about the business, even if it's in the prospectus, there will continue to be some reticence" until enforcement under the new rules is tested by time. That leaves investors still straining their eyes reading acres of fine print. Among upcoming deals, here are four that caught my attention:

» Crocs. Light, colorful, rubberlike clogs and sandals are this Niwot (Colo.) company's thing. And it's a fast-growing thing. Sales in this year's first half neared $37 million, up from $13.5 million for all of 2004. The first half also brought $6 million in profit, reversing a $1.6 million 2004 loss. Crocs shoes are hot, so this issue figures to run fast—until the trend cools.

» Morgans Hotel Group. Has it been 21 years already since the company's first boutique hotel, Morgans, opened in midtown Manhattan? Now Morgans has eight more distinctive spots—Miami's Delano and the Mondrian in Los Angeles among them—and a total of 2,500 rooms. Revenues keep climbing, but look out for Morgans' balance sheet: 88% of its $660 million in debt is floating rate. Higher interest rates will hurt.

» Morton's Restaurant Group. First Smith & Wollensky's paren went public. Then Ruth's Chris Steak House. Now, here comes Morton's, with 69 restaurants in 60 cities. Private equity firm Castle Harlan took Morton's private in 2002, valuing it at $186 million, or 0.8 times revenue and 10 times EBITDA (earnings before interest, taxes, depreciation and amortization). An IPO price has not yet been estimated. At 2002 multiples, Morton's enterprise value would run $235 million to $275 million; Castle Harlan no doubt expects more.

» SAIC. This is set to be the big sleeper of 2006. With $7.5 billion in revenue and $550 million in EBITDA, the San Diego parent of Science Applications International is one of Uncle Sam's top information-technology vendors, serving the Pentagon and, increasingly, homeland-security clients. Formed in 1969, the company is owned by employees. After the IPO, they will keep control, via supervoting stock.

SAIC won't be Webcasting its road show, Crocs might, and Morton's CEO-designate, Thomas Baldwin, told me it's being mulled. Morgans did not respond to my inquiry. Whether or not more companies take advantage of the new, looser rules on pre-IPO publicity, don't toss your reading glasses. ■

E-mail: rb@businessweek.com

Waiting in the Wings

COMPANY/SYMBOL*	COMMENT
Castle Brands ROX	Money-losing boutique boozemaker—Irish vodka, anyone?
Chipotle Mexican Grill CMG	McDonald's selling minority stake in hot burrito chain
Colt Defense CLT	Sole supplier of the military's standard M4 rifle
Crocs CROX	Trendy maker of soft, colorful rubberlike footwear
MasterCard MA	A contender to be the year's biggest new issue
Morgans Hotel Group MRG	Supercool urban hotelier burdened by floating-rate debt
Morton's Restaurant Group MRT	Steaks and more steaks. Average per-diner check: $86.25
SAIC SAI	Employee-owned defense contractor
Thomas Weisel Partners Group TWPG	Investment bank selling itself
Tim Hortons THI	Wendy's spinning off part of Canada's top fast-food chain
Town Sports International Holdings CLUB	Operates New York Sports Club and other city gyms

*Tentative **Data:** Renaissance Capital's IPOhome.com, company reports

Y JAMES C. COOPER

Business Gets Behind the Wheel

Move over housing—corporate spending will drive growth in 2006

U.S. ECONOMY As anyone facing a long trip down the highway this holiday season knows, it's always helpful to switch drivers. Heading into 2006, the economy will be following that same strategy. For the past couple of years, housing and consumer spending have been in the driver's seat. Now it's time for the business sector to give those two a break. And by all indications, companies are ready to take over. They are optimistic, efficient, eager to expand their operations, and most of all financially fit.

This transition is a key theme of the economic forecasters we surveyed in *BusinessWeek*'s annual Investment Guide (page 70). Higher interest rates are one of the forces behind the shift. On Dec. 13 the Federal Reserve raised rates again by a quarter point, to 4.25%, and said it was not yet finished hiking.

As rates rise, the new growth mix already appears to be falling into place. An increasing number of reports from housing starts to mortgage applications to pending home sales suggests that housing is cooling off. Also, household borrowing is slowing, and consumer spending, while still holding up very well, doesn't have the same vibrance it showed in the third quarter.

At the same time, a wide range of businesses is boosting capital spending and increasing hiring. And why not? The economy's rebound from the ravages of Mother Nature and costlier energy has given companies hope for the future. Plus, they have rock-solid balance sheets and a ton of cash to make their ventures happen—so much financial power, in fact, that higher borrowing costs will not be a restraint. And for exporters, growth prospects abroad are looking better all the time.

This changeover is important because one of its key byproducts will be further additions to payrolls and incomes, and that will help to limit the slowdown in consumer spending. As other sources of household buying power, such as cheap money and home equity, begin to diminish, more traditional support for spending from healthy labor markets will take up some of the slack. This virtuous cycle is the chief reason to expect 2006 to be another good year for the economy.

THE LATEST WORD from the nation's chief executives is one of renewed optimism, after the uncertainties created by the autumn storms and their sharp impact on energy costs. The Business Roundtable, which represents companies that account for $4 trillion in sales, reported on Dec. 14 that its CEO Economic Outlook Index rebounded to its second-highest level since the survey began in 2002, after a steep fall in September (chart).

The CEOs polled from 117 companies see "broad economic strength" heading into 2006. They report that capital-spending plans continue to rise and that employment expectations are near their all-time high. The execs expect the economy to grow 3.3% in the coming year, the same average projection of the economists in *BusinessWeek*'s outlook survey (page 74).

EXECUTIVES' OPTIMISM REBOUNDS STRONGLY

Other mid-December soundings corroborate the CEOs' views. For one, Manpower Inc. says that hiring plans for the first quarter remain at a high level. For another, the Institute for Supply Management's semiannual outlook survey shows upbeat expectations for capital spending among both manufacturers and nonmanufacturers. Factories expect to lift their plant and equipment outlays by 9% in 2006, while service-sector companies plan to bump up their spending by 11%.

The manufacturing sector in particular has picked up much momentum in recent months, as seen in stronger orders, rising backlogs of unfilled orders, and the need for many companies to boost their inventories to achieve better alignment with strong demand. And consumer buying keeps rolling along. In November retail sales rose 0.3%, but excluding the sharp drop in gasoline prices that depressed gas station receipts, sales jumped a sturdy 1%.

Inventory data for October show that the growth of business inventories continues to trail that of sales. That pattern pushed the ratio of stockpiles to sales down yet again, leaving it far below its long-term trend and indicating an inadequate level of inventories. That situation will spur production gains in coming months.

PERHAPS THE MOST IMPORTANT REASON to expect the business sector to contribute significantly to overall growth in 2006 is the extraordinary strength of corporate finances. Even though interest rates will likely continue to

rise well into 2006, and with labor costs apt to increase further, businesses in general are sufficiently flush to handle those pressures and more.

To begin with, the balance sheets of nonfinancial companies are about as pristine as they have ever been. Based on recent Fed data, net worth for these companies in the third quarter rose at a 10.3% annual rate from the second quarter, close to the same annual pace during the past two years. That's a strong and steady growth rate not seen since the technology-led stock market boom of the late 1990s.

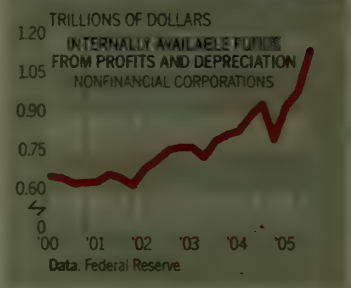
Corporate debt, furthermore, is the most manageable in years. Over that same two-year period, liabilities have increased by $242 billion, but total assets have grown by more than 10 times that amount, by $2.5 trillion. Importantly, credit-market debt stood at only 45.5% of net worth in the third quarter, the lowest ratio in 18 years.

IT'S NOT SO MUCH THAT COMPANIES are in good shape to borrow to meet their financing needs for next year's new buildings, equipment, inventories, and payrolls. It's that, as a sector, nonfinancial businesses don't really have to borrow at all. That's because internally generated funds from profits and depreciation allowances have grown 24.4% during the past year, the largest such increase in 25 years (chart).

Part of that surge reflects a gusher of repatriated earnings coming from overseas operations. Companies were given the opportunity to bring those earnings home at a much reduced tax rate, based on a tax-law change in 2004, and the flow was especially heavy in the third quarter as internal funds skyrocketed at a 79% annual rate from the second quarter. Economists expect the pace of repatriation to accelerate in the fourth quarter.

The rush of funds available for investments is particularly striking, given that internal funds in the third quarter stood $197.5 billion greater than capital expenditures. A gap that size is unprecedented in the more than 50-year history of the Fed's data. In the past, during periods of strong growth it has almost always been the other way around: Outlays for capital spending have exceeded internal funds, an indication of the borrowing needs of companies.

BUSINESSES HAVE MONEY TO BURN



As of November, 2005, this four-year upswing in business begins its fifth year. Throughout the past four, companies have been hit with an assortment of problems such as terrorism, corporate scandal, war, and an energy shock, all of which have generated uncertainty and caution. But over the same period corporations have prudently built up their finances. And with that financial power, businesses are ready to lead the economy further on up the road in 2006. ■

CONSUMERS

Why More Households Are Feeling Flush

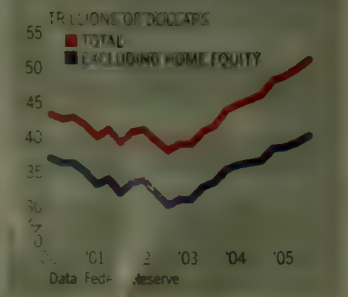
IF YOU WANT TO understand why consumers have been so resilient given everything thrown at them this year, take a look at the Federal Reserve's recently released data on household balance sheets for the third quarter. The numbers show that households are the wealthiest they have ever been, and it's not just because of soaring home prices.

Household net worth, the sum of all assets minus liabilities, increased by $1.3 trillion last quarter from the second quarter. Total liabilities jumped by $331 billion, one of the largest quarterly rises on record, but household assets soared by $1.6 trillion, five times as much.

Only about one-fourth of the rise in net worth last quarter reflected higher home equity, a shade less than the contribution over the past year. Households' cash assets in many highly liquid deposits posted a healthy increase as did the values of stocks and mutual funds.

The rise in household wealth allays concerns over the consumer outlook, including the fretting over holiday buying. With assets growing, consumer spending is unlikely to buckle under higher fuel bills, just as it didn't falter when gasoline was $3 per gallon.

RISING WEALTH KEEPS CONSUMERS SPENDING



Much attention has been paid to this year's negative savings rate, meaning that consumers are spending more than their incomes. But households are saving from sources other than income, and they are spending some of their wealth. The government's conventional savings metric doesn't account for these unconventional behaviors.

Moreover, homeowners are not just frittering away their home equity. For the past two years, Fed data show that home equity as a share of household real estate is up, not down, from 55.8% to 57.1% last quarter.

Record wealth also helps to explain why large increases in debt relative to income remain manageable, even as the Fed has lifted short-term interest rates. Delinquency rates on both mortgages and other types of loans to households remain at very low levels.

In 2006, balance sheets should stay strong. Borrowing will slow as interest rates rise, cooling the growth in liabilities. And even if home prices stop rising, assets should benefit from stock market and other gains. ■

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The Business Week

News you need to know

EDITED BY HARRY MAURER

An Oil Patch Megadeal Many energy industry CEOs don't know what to do with the gusher of money flowing into their tanks. They've resorted mostly to paying down debt, buying back stock, and watching the cash pile up. Not **ConocoPhillips' James Mulva**. The 59-year-old boss, already one of the biggest spenders on new supplies (BW—Dec. 12), put his princely profits on the line on Dec. 12 by agreeing to pay $35.6 billion for gas producer and Houston neighbor **Burlington Resources**. The price is more than triple Burlington's market cap just three years ago. Worried investors drove down ConocoPhillips' share price 7.4% by Dec. 14.

It may be rivals that ultimately quail, however. Mulva figures his company will catapult over six giants, including **Exxon Mobil, BP,** and **Royal Dutch/Shell**, to become No. 1 in the white-hot North American natural gas market. ConocoPhillips is banking on buoyant gas prices over the next few years and beyond that sees the deal opening the way for lucrative plays in liquefied natural gas and Arctic gas.

See "Lots of oomph in oil and gas," page 82, and "Why ConocoPhillips is so hot on gas," www.businessweek.com/go/tbw

Troubled Trade Talks Just about everyone arrived for the Dec. 13-18 **World Trade Organization** conference in Hong Kong knowing it would fizzle. The talks were meant to break the deadlock between developed and developing countries over issues such as farm subsidies and market access, but expectations have fallen so low that some people say the WTO will be lucky if the process doesn't grind to a halt. What's odd is that the inertia behind closed doors seems to be spreading to protesters. On Dec. 14 only a few thousand people took to the streets, and the whole effort felt halfhearted. The highlight? Several dozen Korean[illegible] wearing photogenic bright orange life jackets tried t[illegible] swim to a spit of land where negotiators were cloistered.

See "The WTO's shaky common ground" www.businessweek.com/go/tb[illegible]

Sputtering Carmakers The unthinkable gets mor[illegible] thinkable every day in Detroit. On Dec. 12, **Standard & Poor[illegible]** dropped **General Motors'** debt rating two more levels int[illegible] the junk ditch and said that bankruptcy is not "a far fetched possibility." At the same time, billionaire **Kir[illegible] Kerkorian** quit talks without a deal to get one of his to[illegible] deputies on GM's board. Insiders speculate that he coul[illegible] wage a proxy war to grab the wheel. On the other hand parts maker **Delphi** hinted that it might make a higher octane offer to the **United Auto Workers,** which could hea[illegible] off a strike that would stall GM and cost it billions. Th[illegible] UAW also said on Dec. 14 that it will make concessions t[illegible] **Ford** on its health-care plan for retirees similar to those i[illegible] gave GM, which could save Ford a billion a year in cash.

See "Another credit downshift for GM," www.businessweek.com/go/tbw

Rates Go Up Read between the lines of **the Fed's** Dec. 13 remarks, and outgoing **Chairman Alan Greenspan** seems to be saying: "My work here is almost done." On Dec. 13 the central bank raised the federal funds rate to 4.25%—the 13th increase since June, 2004, when the Fed began weaning the economy off the easy money that had helped spark growth after the 2001 recession. It also hinted that it won't need to tighten much more. That jazzed the bond market and Wall Street, where the Standard & Poor's 500-stock index on Dec. 14 hit a 4 ½-year high.

See "So where's the economy going now?" and "Between the Fed's fewer lines," www.businessweek.com/go/tbw

Cable TV Knuckles Under We have Janet Jackson to thank for this one. The cable industry caved in to Washington on Dec. 12 when six operators, including **Comcast, Time Warner Cable,** and **Advance/Newhouse,** agreed to offer a "family-friendly" programming package. Ever since Jackson bared her breast at the 2004 Super Bowl, federal lawmakers and regulators have been raging to clean up TV—especially cable, where content is unregulated. **Senate Commerce Committee Chairman Ted Stevens** (R-Alaska), who once threatened to extend broadcast indecency restrictions to cable, says he'll call off the legislative dogs if the cable companies do the right thing.

***Et Tu,* Steve?** On Dec. 11, **Steve Case,** co-founder of **AOL** and until recently a **Time Warner** board member, went over to the enemy, joining the **Carl Icahn** camp in advocating a breakup of the media behemoth. Of course, given the way many Time Warner shareholders feel about the man who helped engineer the merger that eventually vaporized $135 billion in equity, Icahn may wish Case had kept quiet. Meanwhile, AOL kept talking with **Google** and **Microsoft** about a search and advertising partner-

ip, and **Bill Gates,** visiting India, speculated that Mi-osoft might reward users of its search engine with a ece of the ad revenue it generates.

edstone's Hungry Progeny The contest for **Sumner edstone's** heart is in full swing. In the weeks since his **Via-m** split in two, both new Viacom and new **CBS** have hus-ed to plump up their assets. Viacom, eager to return the fading **Paramount** studio to star status, hooked **DreamWorks'** live-action unit with a steep $1.6 billion bid, stealing the scene from **General Electric.** That gives Paramount a 60-film library including works from **Steven Spielberg** (*Saving Private Ryan*, photo) as well as a potential blockbuster in the distribution rights for movies made by DreamWorks' animation company. CBS has been making noise that it, too, may be scouting a good-sized deal to buttress its TV networks and **Infinity** ra-io chain, which it's renaming **CBS Radio.** It recently ought the **College Sports TV** cable channel for $325 million nd pondered a bid for the **Hallmark Channel.**

See "DreamWorks: Enter the tough guy," page 44, and "Memo to GE: Don't cross David Geffen," www.businessweek.com/go/tbw

elta Wins One The duel shaped up like a spaghetti Vestern showdown. After filing for bankruptcy in Sep-ember, **Delta Air Lines** asked a judge to force its pilots to ake $325 million in pay and benefit cuts. The pilots, al-eady smarting from $1 billion in annual givebacks greed to last year, seemed set to strike, which could have ut the carrier six feet under. But on Dec. 11, the **Air Line ilots Assn.** flinched, accepting a 14% pay trim that will ave Delta $143 million a year. It's unlikely this marks the nd of the standoff: The deal must be ratified, and it ight not go far enough. Delta may need another fistful f dollars to stay aloft.

Merck's Latest Lumps It was a draw, but Wall Street aw it as a loss. On Dec. 12 the judge in Merck's first feder-l case involving its withdrawn painkiller Vioxx declared a istrial after jurors couldn't agree. Investors had expected Merck to win because the case involved the death of a man vho had taken Vioxx for less than a month. Merck also ooked bad a few days earlier when the ***New England Journal f Medicine*** ran an editorial chiding researchers, including wo Merck employees, for not including three heart attacks n a 2000 study the journal published. A Merck attorney ays the heart attacks were left out because they came after specified cutoff date for the data, but plaintiffs' lawyers icked their chops at the prospect of using that info at trial. There was one cheery prognosis: On Dec. 14 an **FDA** panel ecommended approval of a Merck vaccine against a virus hat causes severe childhood diarrhea.

See "Merck's plan for relief," www.businessweek.com/go/tbw

Sweet Doughnut Deal These days, one could be forgiven for imagining that private equity will soon own everything, everywhere. A trio of buyout firms on Dec. 12 said they'd pay a sugary price of $2.43 billion for **Dunkin Brands. Pernod Ricard,** the French wine and spirits vendor, is dumping Dunkin, along with Dunkin's **Baskin-Robbins** ice cream and **Togo's** sandwich chains, to pay off debt. But this is no turnaround play for buyers **Bain Capital, Carlyle Group,** and **Thomas H. Lee Partners.** They like the doughnut chain's recipe to nearly triple in size, to 15,000 outlets worldwide, in the next 10 years, and they're keeping management in place. Dunkin has been taking on **Starbucks** by selling lattes and cappuccinos for less, but it's fattening nicely by aping its competitor's "be everywhere" strategy.

Putting More Heat on Wendy's And in the grill galaxy of the fast-food universe, chains that rely on twentysomething men for a supersized chunk of their sales are getting orders from an older cohort—hedge fund managers. Instead of cheeseburgers, these guys want divestitures, and they just may get their way at **Wendy's International.** On Dec. 13, **Nelson Peltz's** latest vehicle, **Trian,** disclosed a 5.5% stake in Wendy's. Trian told the Dublin (Ohio) company it should sell off all its ancillary brands, including Canadian doughnut giant **Tim Hortons.** Back in July, Wendy's agreed to offer 15% of Tim Hortons to the public to calm the appetites of **Pershing Square Capital Management,** which owns 10% of Wendy's. Pershing Square also owns 4.9% of **McDonald's** and is pushing the company to spin off its company-owned outlets. Big Mac says that would hurt results.

Fiasco of the Week

How do you say "unfortunate typing mistake" in Japanese? Tokyo markets are abuzz about the mother of all trading errors that saddled colossus **Mizuho Financial Group** with $335 million in losses and triggered the resignation of **Tokyo Stock Exchange President Takuo Tsurushima.** A Mizuho staffer on Dec. 8 offered 610,000 shares of recently listed recruiting company **J-Com** for one yen apiece, when he meant to sell one share for 610,000 yen, or about $5,630. Worse, on Dec. 11 the TSE admitted that Mizuho frantically tried to stop the trade, but the exchange's computers refused to do so for 10 agonizing minutes, during which predatory investors snapped up the dirt-cheap shares. That was doubly embarrassing for the exchange, which suffered a meltdown that halted trading back in November. So *sayonara*, Tsurushima-*san*. This being Japan, Mizuho bigwigs have been bowing deeply before cameras (photo)—and buying back shares at a painful premium.

HEALTH CARE

THEY THINK THEY'RE INSURED. THEY'RE NOT

Millions of Americans are buying medical "discount cards" that don't deliver on their promises. Now states are taking action

BY AARON BERNSTEIN AND JOSEPH WEBER

MICHELLE S. O'KELLEY considered herself a fairly savvy health-care consumer. A diabetic since the age of four, the 42-year-old Minneapolis resident knew that if she went without health coverage for even a short stint, insurers would label her diabetes a preexisting condition and deny coverage for a year. So when she lost her job as an employment counselor last January, O'Kelley hopped online and signed up for a plan offered by the International Association of Benefits (IAB). Its Web site said she would get "insured benefits" from doctors, hospitals, and other providers for $169 a month.

It sounded good. But her discount card knocked just 50¢ off her $75 bottle of insulin. Then in April, when O'Kelley landed a job that provided health care, the insurer denied coverage for illness related to her diabetes for a year. Why? Because, it told her, IAB sells discounts from medical-care providers, not insurance. "I can't believe I was such a sucker," says Kelley.

She's hardly alone. Illinois and Texas have filed lawsuits accusing IAB of misleading consumers into thinking its discount plans are health insurance. (IAB founder James Wood says he's trying to settle the suits and that his 5,000 independent agents tell customers that its plans aren't insurance.) And across the country, a rising tide of complaints about fraud and deception by discount card companies has prompted action by dozens of other states. Twenty now require companies that offer discount cards to say expressly that discount plans aren't insurance.

FLY-BY-NIGHT HUSTLERS

EVEN SO, THERE'S a new indicator of spreading card confusion: As many as 17% of the U.S.'s 40 million temporary and part-time workers—7 million people—say they have health insurance when they actually only have discount cards. That's according to a study released in December by the Iowa Policy Project, funded by the Labor Dept. and the Commonwealth Fund and conducted by pollsters Lake, Snell, Perry, Mermin & Associates Inc. The pollsters first asked a sample of nonstandard workers if they had health insurance. They then re-interviewed those who said yes to determine exactly what they had. University of Iowa economics professor Peter Fisher says he and his colleagues were shocked by the findings, which suggest that discount cards are masking an explosion in the ranks of the uninsured far beyond the 46 million reported by the Census Bureau this fall.

Many discount card companies offer valid savings on services such as doctors' visits and prescription medicines. But because they typically aren't selling insurance, they're usually not regulated by state insurance commissioners, creating an opening for scammers. Todd Cioni, who heads the compliance unit of Maryland's Insurance Commission, says some

SO IN THIS SECTION:

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42 Washington whispers to Wall Street

44 Tough love at DreamWorks

card companies are fly-by-night hustlers that blast-fax pitches and make cold calls hyping discounts of up to 95% that turn out to be far less. In Texas, Family Health Corp. and Family Care/NAPP recently settled a lawsuit over allegedly misleading ads. Although the companies maintain they did nothing wrong, they decided it was advantageous to pay $312,500 to settle the suits, says Kristopher A. Rabie, president of the parent company of Family Health. It does business with Family Care, whose CEO is his father, Mahmoud Rabie.

Some victims get hit by what they see as outright fraud. That happened to Mary (not her real name, which she's too embarrassed to give). When the 32-year-old resident of Havre, Mont., got pregnant, she ponied up $289 for what she was told was health insurance to a Tampa company that has since disconnected its phone. It sent her a card her doctor and hospital wouldn't accept, she says. Says John M. Morrison, state auditor for Montana, which cracked down on card companies last year: "There are a lot of illegal discount plans advertising in misleading ways."

O'KELLEY Her discount card knocked just 50¢ off her $75 bottle of insulin

PRICE RELIEF

TO BE SURE, MANY discount cardholders buy their cards from more legitimate players, which can provide a much-needed service. In the past decade or so, soaring medical inflation has prompted the insured and uninsured alike to seek price relief. Card companies can negotiate group discounts of 10% to 30% for individuals, who often can't get the lower prices traditional insurers squeeze out of health providers. Doctors sign on to get new patients. The cards offer "tremendous value" to some consumers, says Thomas R. Beauregard, a senior vice-president in the health-access strategies unit of United Health Group Inc. The Minnetonka (Minn.) insurer provides the discount card to 400,000 people who get it from their employers or buy it at outlets such as Sam's Club. For $6 to $10 a month, they get discounts from United Health's 400,000-strong provider network.

Overall, Americans have snapped up as many as 20 million discount cards, estimates Vince DiBenedetto, CEO of Chicago-based Coverdell & Co., a unit of Vertrue Inc., a publicly traded marketing outfit. Coverdell alone has 3.5 million cardholders, he says.

While discount card execs say they work hard to make sure customers know their cards aren't insurance, they acknowledge that the industry has a growing image problem. Card companies formed the Consumer Health Alliance in 2002 to self-monitor the industry and work with state regulators. But an investigation by Maryland's Insurance Commission last fall found misleading sales pitches implying that the cards were insurance and involving hidden fees and unauthorized billings. Companies there and in other states hawk cards with messages such as "Save on Healthcare & Prescription Drugs. Everyone Accepted!" and "Healthcare Discounts Up to 95%."

The only in-depth examination of the industry thus far turned up a raft of similar problems. Last year researchers at Georgetown University's Health Policy Institute purchased five discount cards available in the Washington area. They called 44 medical providers listed as members of the cards' networks. The result: Only 16 honored the card, and only nine would give an estimated discount prior to performing the service. Only one card listed providers that all offered discounts.

Even when discounts were real, they weren't always what they were cracked up to be. They varied from 4% to 36%, much less than the 80% promised by two cards. In some cases providers told the Georgetown researchers they offered similar or even greater discounts to uninsured consumers without cards. "We already offer patients willing to prepay their bill a 30% discount," says Michelle R. Leone, vice-president for patient financial services at Beth Israel Deaconess Medical Center in Boston. She says her hospital, which wasn't part of the study, doesn't accept discount cards.

If state governments are able to crack down on the scammers, discount cards could end up helping the uninsured. Florida is one of the strictest, requiring card companies to get licensed like insurers. That has reduced complaints, says Florida Deputy Insurance Commissioner Rich Robleto. He's leading a committee of the National Association of Insurance Commissioners to draw up a model law that all states could adopt. That would be a first step in addressing a growing national problem. ■

–With Amy Barrett in Philadelphia and Catherine Arnst in New York

Discount—Or Ripoff?

Medical discount cards can offer consumers value, but experts say the fast-growing industry has been troubled by accusations of fraudulent behavior. Some of the complaints:

MISLEADING ADS Cards are often marketed as "health plans" and "deductibles," which can lead consumers to think they're buying health insurance

PHANTOM PROVIDERS Many cards list doctors and hospitals as providers that do not participate and do not honor the cards

PHONY DISCOUNTS Consumers often can't tell if the discounts are real, and even those that are real are much less than promised

FALSE BILLING Some card companies require credit-card or bank information, then bill consumers even after they have canceled cards

LITTLE OVERSIGHT The cards aren't insurance, so they're not regulated by state insurance commissioners and often fall between the regulatory cracks

Data: BusinessWeek

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THE INTERNET

AT STAKE: THE NET AS WE KNOW IT

Google *et al* fear broadband carriers will tie up traffic with new tolls and controls

BY CATHERINE YANG

THE INTERNET HAS ALWAYS been a model of freedom. Today the Web is flourishing because anyone can click to any site or download any service they want on an open network. But now the phone and cable companies that operate broadband networks have a different vision. If they get their way, today's Information Highway could be laden with tollgates, express lanes, and traffic tie-ups—all designed to make money for the network companies.

That prospect is the worst nightmare of Internet stars such as Google, Amazon, and eBay. They're gearing up for a clash with the phone and cable giants early next year as Congress begins to redraft the telecom laws for the broadband era. The Internet gang fears that unless they get lawmakers to intervene, the network operators will soon be able to put a chokehold on the Web. "The issue is about the future of the Internet," says Alan Davidson, Google Inc.'s Washington policy counsel.

Doug Herring, 48, got a glimpse of that specter last November. Traveling on business in Tennessee, the General Electric Co. sales manager phoned his wife at their Elberta (Ala.) home. Herring had just signed up with Web-phone provider Vonage Holdings Corp. and was pleased with the service. But this time, he couldn't get through. He switched Web-phone providers, but still couldn't make calls.

Frustrated, Herring contacted Madison River Communications LLC, the rural phone company that provides his digital subscriber line (DSL) connection. The company said it was blocking calls from Internet phone companies. Outraged, Herring and Vonage complained to federal regulators. "For me to get the Internet where I live, [Madison River] is the only provider," Herring fumes. In March the Federal Communications Commission fined the company $15,000, and the carrier agreed it would no longer block Internet-calling services.

INTERNET FIEFDOMS?

MOST PHONE and cable companies are no longer content just to sell Web access to consumers. After investing in high-speed pipes, they also want to peddle more lucrative products, such as Internet-delivered TV programs, movies, and phone calls. "Building these networks is expensive," says Link Hoewing, vice-president for Internet policy at Verizon Communications Inc. "If I can find new ways to pay for this network, it's gravy for everyone."

But selling those extras puts the phone and cable companies in competition with Web services big and small. The network operators could block consumers from popular sites such as Google, Amazon, or Yahoo! in favor of their own. Or they could degrade delivery of Web pages whose providers don't pay extra. Google's home page, for instance, might load at a creep, while a search engine backed by the network company would zip along. "This new view of the world will break apart the Internet and turn it into small fiefdoms" divided between the network providers' friends and foes, says Vonage Chief Executive Jeffrey A. Citron.

That's just crying wolf, retort the Bell and cable operators. The Web companies' push for rules requiring "network neutrality is a solution in search of a problem," says Daniel Brenner, senior vice-president for regulatory policy at the National Cable & Telecommunications Assn. But recent court and regulatory rulings have given the carriers more room to discriminate. In June, the U.S. Supreme Court ruled that cable broadband services were almost free of regulation. Two months later, the FCC granted the same liberty to the Bells' broadband services. The FCC made two newly merged megaphone companies—created from AT&T and SBC Communications Inc. and Verizon and MCI—vow to keep their Internet lines open to all for the next two years. But FCC Chairman Kevin J. Martin favors a light regulatory

Political Connections

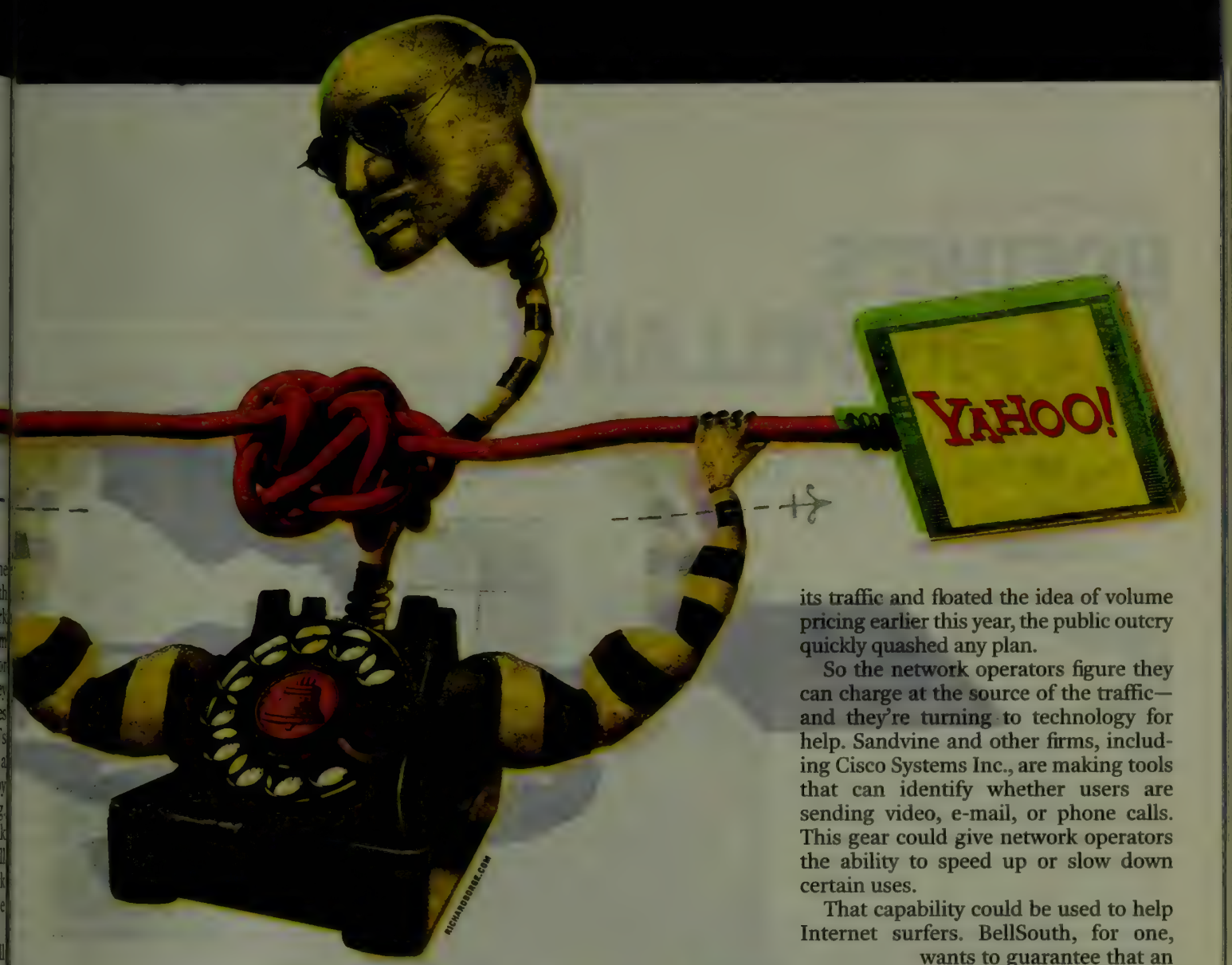
When it comes to funding congressional candidates, Old Media—the Bells and cable—swamp the New Economy. One Bell, SBC Communications, has given more to politicians this year than six Web-oriented companies combined:

CONTRIBUTIONS TO CANDIDATES FROM JAN. 1 THROUGH OCT. 31, 2005

The Bells*	Cable Companies**	New Economy†
$2,268,675	$698,150	$921,137

* BellSouth, SBC Communications, and Verizon Communications ** Cablevision, Charter, Comcast, Cox, and Time Warner Cable † Amazon.com, eBay, Google, IAC/InterActive, Microsoft, Yahoo!

Data: Center for Responsive Politics, from Federal Election Commission filings



ouch until he sees widespread abuse by ne networks.

Lawmakers updating the telecom laws re more likely to act. The House Comerce Committee will probably vote ear- next year on whether to require net eutrality. And while Google and its Inernet brethren are the darlings of Wall treet and a Web-wild public, these New conomy powerhouses could find themelves outgunned in Washington. After ecades as regulated carriers, the Old ech phone and cable companies employ egions of lobbyists and funnel hefty hecks into Congress's campaign coffers. oogle, by contrast, just hired Davidson, s first lobbyist, in June.

ANDWIDTH ROAD HOGS

OR THEIR PART, the phone and cable ompanies protest that they have no lans to use their pipes unfairly. Madion River is the only carrier known to ave blocked rivals or degraded their ervice. "We have no intention of conrolling where you can and can't go on he Internet," says Bill Smith, chief echnology officer at BellSouth Corp. "If phone companies] restrict where people go on the Net, they'd leave in droves" for cable competitors.

Yet in a Nov. 7 interview with BusinessWeek Online, AT&T CEO Edward E. Whitacre Jr. declared: "What [Google, Vonage, and others] would like to do is to use my pipes free. But I ain't going to let them do that." Whitacre and AT&T argue that they need flexibility to exact a toll from Web services that hog bandwidth. As broadband use grows, the Bells and cable companies say that intensive users aren't paying their fair share. File-sharers swapping music and movies account for 60% of North American residential broadband use, estimates Dave Caputo, CEO of Sandvine Inc., in Waterloo, Ont., which sells technology to manage network traffic. "Your overeaters get preferential treatment over weaker ones," he says.

Recent rulings give carriers more room to pick their favorites

Carriers could raise their prices for consumers who clog the network. But when Korean phone giant KT Corp. noted that 5% of its users accounted for half of its traffic and floated the idea of volume pricing earlier this year, the public outcry quickly quashed any plan.

So the network operators figure they can charge at the source of the traffic—and they're turning to technology for help. Sandvine and other firms, including Cisco Systems Inc., are making tools that can identify whether users are sending video, e-mail, or phone calls. This gear could give network operators the ability to speed up or slow down certain uses.

That capability could be used to help Internet surfers. BellSouth, for one, wants to guarantee that an Internet-TV viewer doesn't experience annoying millisecond delays during the Super Bowl because his teenage daughter is downloading music files in another room.

But express lanes for certain bits could give network providers a chance to shunt other services into the slow lane, unless they pay up. A phone company could tell Google or another independent Web service that it must pay extra to ensure speedy, reliable service.

That could result in an Internet of haves, who can afford to pay the network operators more to ensure smooth service, and have-nots. Trouble is, those have-nots may include the Next Big Thing—whether it be mom-and-pop podcasting or video blogging. The fewer innovative services on the Net, the less reason Web users have to want broadband. Both the network operators and the Internet could lose out in the end. ■

–With Roger O. Crockett in Chicago and Moon Ihlwan in Seoul

ART OF THE DEAL

BOEING'S JET PROPELLANT

Its sales ace is pushing the company ahead of Airbus in the rich Asia-Pacific market

BY STANLEY HOLMES

FOR THE PAST DECADE, AIRbus dealmaker John J. Leahy has struck fear into the heart of Boeing Co. executives. It was Leahy, after all, who helped the European jetmaker supplant Boeing as the world's top producer of commercial jetliners. And on Dec. 5, with Qantas Airways Ltd. executives debating whether to award one of the largest jet orders of the year to Airbus or Boeing, it looked like Leahy might triumph once again.

What had Boeing officials so worried that day was Leahy's last-minute flight to meet with Qantas executives in Sydney. Time and again, the Airbus super-salesman had pulled off victories at the 11th hour. But this time, the urbane Leahy met his match. His rival at Boeing, the decidedly less glamorous Larry S. Dickenson, won the day: On Dec. 13, Qantas decided to purchase up to 115 Boeing 787 Dreamliners, valued at roughly $10 billion at list prices. The news of the deal sent Boeing shares to $71.45 on Dec. 14—a record high.

The Qantas contract is Dickenson's second recent victory in the battle for control of the lucrative market for widebody airplanes in the Asia-Pacific region. On Dec. 1, Chicago-based Boeing won an order for 16 777 widebody jetliners from Cathay Pacific Airways Ltd. It now controls more than 60% of the Asian widebody niche. With Asia-Pacific the world's fastest-growing market for new aircraft, and the biggest buyer of the longer-range and highly profitable widebody jets, Dickenson's Cathay Pacific and Qantas wins will help boost Boeing's bottom line for decades.

DICKENSON He oversees the tiniest detail of each sales campaign

Dueling Dealmakers

Estimated value of Asia-Pacific **JET SALES** this year*

BOEING'S DICKENSON	$26 Billion
AIRBUS' LEAHY	$9 Billion

Data: Boeing, Airbus
* Deals announced in 2005

Of course, Dickenson knows it's easy to look good when customers are clamoring for your product. Boeing has a game-changing plane on its hands with the lightweight, fuel-sipping 787 Dreamliner. At the same time, Boeing, after reining in its salesmen during the '90s, has again given them more autonomy to cut deals without checking back with headquarters.

To hear Dickenson tell it, there's nothing particularly impressive about what he does for a living. "I'm just a jet salesman," he says. "We have good products, and we try to demonstrate [their] value." Of course, it's not so simple. Like his rival at Airbus, Dickenson, 62, is part of an exclusive club of über-salesmen. Not only do he and his peers battle over deals worth billions of dollars, they affect the balance of trade between countries. As such, they need to win over not just airline executives but politicians, too. And there is always the chance that the other guy will snatch away the big deal. "I'm always nervous when John [Leahy] is in Asia," Dickenson says. "I'd prefer he spend his time in Europe or the Middle East."

INDUSTRY GOLF TOURNEY

MAYBE DICKENSON shouldn't worry so much. He has connections in Asia-Pacific built up over 18 years. He plans meticulously for each sales campaign, overseeing the tiniest detail down to the wording of press releases. He comes up with creative solutions that often include a combination of attractive pricing, financing, and leasing arrangements, as well as training and service packages. And he's a big believer in creating "action-enforcing events" timed to spur airline executives to close the deal.

That, of course, requires good old-fashioned schmoozing. And how better to woo golf-mad Asians than at a Boeing golf tournament? Every November Dickenson hosts one in Hawaii for about 100 industry guests. The event has become a classic, heading into its 18th year. "One time we had a '50s night," recalls a former Boeing executive. "We had makeup artists to paint sideburns and hand out T-shirts, and guests just ate it up." The occasion includes meetings and the opportunity for senior Boeing officials to meet customers one-on-one. The tournament format, called scramble, puts Boeing and industry execs together in four-person teams. "When you play four hours of golf a day, you get to know your team," Dickenson says.

Boeing and its top salesman have now won two of three crucial campaigns in Asia-Pacific. And the most dramatic win may be just around the corner. The leader in the region, Singapore Airlines Ltd., is expected to announce a big purchase in January. If Singapore swings to Boeing, as insiders suggest it will, then the aerospace Goliath will have pulled off one of the biggest strategic reversals in commercial aviation history. And Dickenson will have made Leahy's job a lot harder. ■

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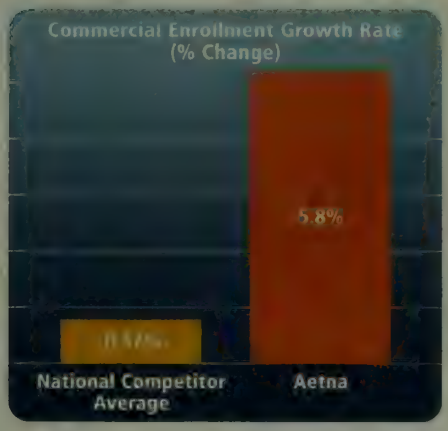

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CAPITOL HILL

WASHINGTON WHISPERS TO WALL STREET

Low-profile firms enjoy a lucrative business selling 'political intelligence'

BY EAMON JAVERS

DAY TRADERS WERE CONfused. On Tuesday, Nov. 15, they couldn't figure out why there was so much action in USG Corp., a Chicago building-materials company whose subsidiary is mired in asbestos lawsuits. The stock was trading at double the normal daily volume and would gain $2.12 to close at $61.55. But there wasn't any major news to power the run-up.

Public news, that is. Behind the scenes, Senate Majority Leader Bill Frist (R-Tenn.) had decided to override the qualms of Budget Committee leaders and press ahead with a bill to create a $140 billion fund to relieve companies such as USG of their asbestos liabilities. Frist wouldn't announce his move until Nov. 16. But the news got to key Wall Street players a day early via a little-known pipeline: a small group of firms specializing in "political intelligence" that mine the capital for information and translate Washington wonkspeak into trading tips.

The business started with a couple of cottage firms in the early 1970s. But now it's taking off. Industry insiders say the explosion of hedge funds has driven new clients and bigger dollars to Washington-watchers. "What hedge funds do is look for inefficiencies in the market," says one hedge fund manager who buys several firms' reports. "And Washington is the world's greatest creator of [market] inefficiencies."

Unlike lobbyists, political intelligence outfits are not required to disclose their clients or annual revenues, masking the size of this very quiet business. One veteran estimates there are more than a half-dozen contenders collectively raking in $30 million to $40 million a year. Prominent players include the Washington research shops of Prudential, Lehman Brothers, and Stanford Washington Research Group, owned by Stanford Financial Group of Houston.

> Explosive growth in hedge funds has business booming

The business stretches beyond Capitol Hill. "We analyze public policy—macroeconomics, the Fed, budget, trade, currency—that affects overall financial markets, sectors, or companies," says Leslie Alperstein, a founder of the firm Washington Analysis. And while leaks such as Frist's asbestos news are welcome, Alperstein says his business is mostly about explaining trends. "If we only dealt in [hot tips], I wouldn't be living in Potomac," he says, referring to a pricey Maryland suburb. "It doesn't happen often enough."

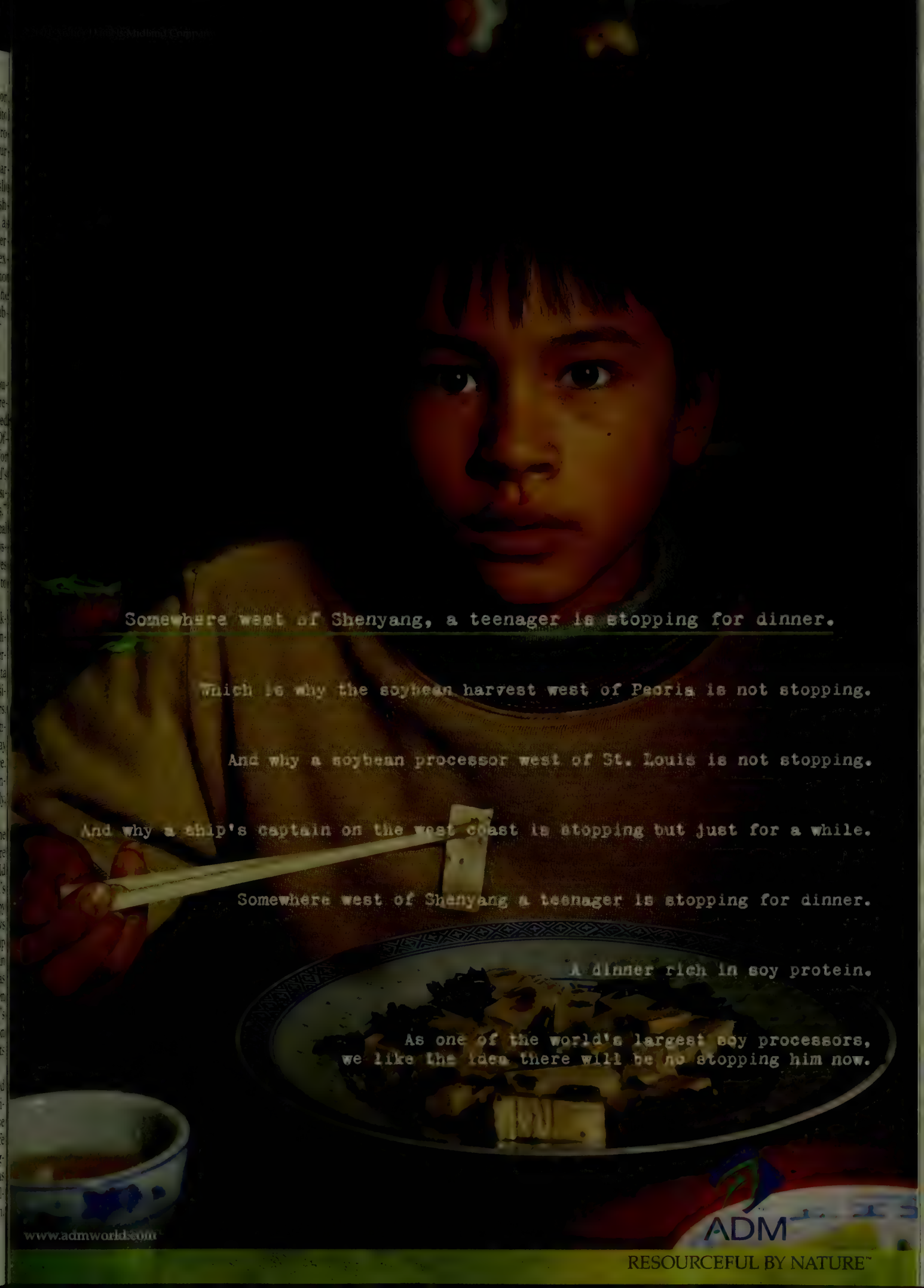
LOOSE STANDARDS

IT HAPPENS ENOUGH, however, to trouble some lawmakers. On Nov. 23, Representative Brian Baird (D-Wash.) asked the House Committee on Standards of Official Conduct to issue guidance for staffers sitting on some of the capital's most valuable information. "The possibility of direct kickbacks [is] enormous," says Baird, who read about the political intelligence business in *The Hill*, a newspaper covering Congress. He worries that the trafficking comes "very close" to insider trading.

But ethics experts say no one's breaking the rules. Hill staffers and government employees are forbidden from personally profiting from confidential data and can't share information that's classified or deemed secret by their employers. But within those loose standards, political intelligence is just another legal way for investors to perform due diligence. The intelligence operatives say that Congress, where decisions are made publicly, is fair game.

As the value of their product rises, the political intelligence firms themselves are becoming fair game. Alperstein sold Washington Analysis in July to China's Xinhua Finance, which is 6.5%-owned by government-controlled Xinhua News Agency. Xinhua picked up Washington Analysis for an undisclosed amount just as the bidding war between Chevron and China's CNOOC over the acquisition of Unocal was reaching its apogee this summer.

Chevron outmuscled CNOOC for that deal—evidence that the Chinese didn't fully understand life inside the Beltway. That might be changing. For Chinese communists as well as Wall Street traders, there's increasing value in getting smart about capitalism, Washington-style. ■


Somewhere west of Shenyang, a teenager is stopping for dinner.
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TINSELTOWN

DREAMWORKS: ENTER THE TOUGH GUY

Roger Enrico may have been too nice. Will Lewis Coleman impose discipline?

BY RONALD GROVER

CHANGING DIRECTORS mid-shoot is classic Hollywood. And that seems to be what's happening at DreamWorks Animation SKG Inc. On Dec. 5 it brought in board member Lewis W. Coleman as president to provide more adult supervision over a studio that has bungled its early days as a public company.

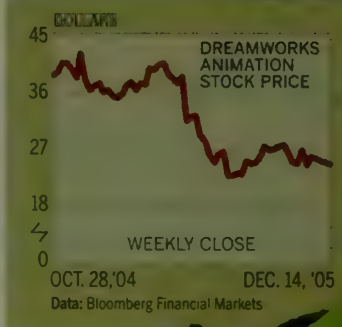
Hey, wasn't Roger A. Enrico supposed to be the adult? Last year, DreamWorks Chief Executive Jeffrey Katzenberg recruited the former PepsiCo Inc. CEO to bring some business world gravitas to the studio as chairman. Having starred in the late-'90s turnaround at Pepsi, Enrico, 61, was quite a catch. After all, Enrico is no stranger to the entertainment industry; he was responsible for the groundbreaking 1980s deal that paid Michael Jackson $5 million to promote Pepsi. At DreamWorks, he helped woo investors and struck lucrative ventures with the likes of McDonald's Corp. and Kmart Corp.

But fizzy drinks and salty snacks are a long way from animated ogres and Tinseltown hype. Enrico, who will remain chairman, acknowledges the learning curve has been steep at a time when the studio has lowered earnings targets, drawn the ire of the Securities & Exchange Commission, and scared off investors. "It became clear we needed to bring in someone else" to help out, he says.

For outsiders like Enrico, Hollywood can be like watching an old David Lynch flick—a real brainbender. Runaway costs are routine, and relationships often count more than the bottom line. And at DreamWorks, Enrico worked only two days a week and consulted mostly on marketing and investor relations. But four months into the job, Enrico discovered his CEO was more interested in making movies than in minding the store. Katzenberg routinely jetted off to Britain to keep an eye on the making of *Wallace & Gromit: The Curse of the Were-Rabbit*, say, or to India to supervise new animators. At PepsiCo, says Enrico, "I was CEO, and I didn't make the Fritos."

ENRICO It ain't Pepsi

INANIMATE



Data: Bloomberg Financial Markets

Given all the problems at DreamWorks Animation, having a CEO on the premises might have been a good thing. In May the studio warned that it would sell fewer DVDs of *Shrek 2* than it had anticipated. Pretty soon the stock was in free fall, the SEC had launched an informal probe into DVD sales accounting, and the company was hit with shareholder lawsuits accusing management of overselling the company's prospects. In November it announced a $656,000 loss on revenues of $81 million, due in part to a $3.9 million writedown on *Wallace & Gromit*. "The complexities of running a public company were more than I anticipated," says Katzenberg.

If Katzenberg made a mistake, it was overhyping *Madagascar*. Talking up films is as Hollywood as buzz and Botox. But it's dangerous at a small studio where films account for most of the profits. Also, studio auditors didn't realize until too late that *Shrek 2* DVD sales were failing to meet projections.

By all accounts, Enrico is too nice and wasn't around enough to impose discipline on Katzenberg and crew. The job calls for someone willing to stand up not just to Katzenberg, but also to Steven Spielberg and David Geffen. Along with Katzenberg, they still control 59% of the animation studio—though they are selling the live-action studio, DreamWorks SKG, to Paramount Pictures.

Coleman is a tough guy from central casting. First recruited to chair the audit committee, the former Bank of America Corp. CFO is willing to step on toes—even Gucci-clad ones. Coleman, whose new title is president, likely will cut costs and strengthen accounting. And Enrico, who is voluntarily giving up $2 million in bonus compensation to help pay Coleman? "For now we'll go with the flow," he says.

The changes are winning little applause on Sunset Boulevard or Wall Street. Asks analyst Richard Greenfield: "Why will it be better with someone new from the outside?" That's a very good question indeed. ■

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JAPAN

BETTER THAN ROBOTS

Japan is turning to hyper-skilled *supaa ginosha*, or super technicians, to preserve its manufacturing edge

BY KENJI HALL

BEHIND THE LOCKED doors of a Sharp Corp. factory in the central Japanese city of Nara, Rina Masuda spends her days at a task most people would find both mind-numbing and infuriating. With the searing tip of a soldering iron, she guides droplets of molten metal on a circuit board to the edges of a microchip. In less than a minute she has the chip standing on dozens of tiny metal legs separated by a hair's breadth to keep electrons flowing smoothly. Masuda's job seems at odds with the bank of machines just a few yards away that spit out hundreds of circuit boards every hour. Yet Masuda doesn't fear losing her job to automation, at least not until the equipment is as precise as she is. When the machines botch a job, she's called in to fix up the chips. "The soldering I do by hand is far superior to anything the machines can do," says the 33-year-old.

Japan has thousands of workers like Masuda, with talents so extraordinary that no machine can do their jobs. Their skills have amounted to the X factor that has given Japan a manufacturing edge for decades. But for years these industrial stars toiled in obscurity as Japan's emphasis on teamwork made companies reluctant to single them out. Then in 1998 the government decided it was time to recognize their contributions with a title: *supaa ginosha*, or "super technician." Each of the laureates—3,800 so far, with hundreds more added every year—gets a certificate and a flower-shaped silver lapel pin stamped with a character meaning "technique." What they often don't get is money. For most super workers, the honor is enough.

In sectors ranging from semiconductors to shipbuilding, these shop-floor specialists at hundreds of companies do their jobs with uncanny precision and usually—but not necessarily—hyper-productivity. At Toshiba Corp., 56-year-old Hidetoshi Murakami makes molds for semiconductors just one-10,000th of an inch thick. Masanori Suzuki, a 44-year-old mechanic at Central Japan Railway Co., knows every nook and cranny of bullet trains, or *shinkansen*, and leads a team that can complete a top-to-bottom inspection—removing wheels, checking circuit boards, brakes, and doors, and test-driving—in 12 days. And at Matsushita Electrical Industrial Co., 30-year-old Toshio Watabe pieces together tiny speakers and amplifiers to make hearing aids the size of a pencil eraser. "We taught him the basics, but he was motivated to perfect his skills on his own," say Watabe's supervisor, Susumu Maeno.

RINA MASUDA 33
Sharp
Remounting chips smaller than a fingernail onto circuit boards for laptops and other gadgets

Now the *supaa ginosha* movement i getting a renewed boost from governmen and industry, which see these top worker as a vital tool in sustaining Japan's recov ery and even preserving its industrial bas Manufacturing in Japan faces two threats the menacing power of cheap Chinese la bor and a profound demographic shift a home. In 2006, Japanese baby boomer will begin to retire, and with declinin birth rates, a quarter of all Japanese will b over the age of 65 by 2015. So instead o looking to shed workers as they did durin the 1990s, Japanese companies today nee to squeeze more productivity and skills ou of a shrinking labor force. "These top tech nicians...can raise our manufacturing abil ity to a higher level," says Shohgo Fuka hori, Sharp's head of personnel. "Once they're gone, we won't be able to make certain products. We need to preserve the knowhow."

Technology won't offer any quick fix "Robots can assemble products or do the heavy lifting, but the work has to be repetitive, simple, and precise," says Yasushi Tomita, an executive at Yaskawa Electric Corp., a major robot maker. "It will be years before they will be able to do the work of most skilled technicians."

PASSING IT DOWN

ENTER THE *SUPAA GINOSHA*. While Japan churns out some of the highest-quality goods on the planet, it hasn't had any systematic way for its hyper-skilled workers to pass on their collective expertise to the next generation. Officials seeking a way to recognize these workers looked to the "Living National Treasures" program, the highest honor for temple builders, kimono weavers, Kabuki actors, and other practitioners of ancient arts. That system has kept alive methods and knowledge that may otherwise have been

OSHI HOSOYA 50
awajima-Harima y Industries

Applying the metallic layer of the main shaft of gines

st, an encouraging sign for the *supaa ginosha* initiative. "Eventually, super technicians could be contracted out to help ther Japanese companies gain crucial nanufacturing knowhow," says Shigeru suji, a professor emeritus at Tokyo Institute of Technology and head of the committee that created the program.

Mostly, though, the *supaa ginosha* pass long their knowledge to colleagues in heir own companies. At Sharp, for instance, Masuda and her 34-year-old colleague, Kayoko Yamabe, give classes over he company's intranet and have been ent to help train workers at other factories in Japan and the U.S. And 61-year-old Mitsuo Kihara teaches younger workers t a Canon Inc. plant near Tokyo how to rind and polish lenses used in semiconductor manufacturing equipment.

Over at ship and aircraft maker shikawajima-Harima Heavy Industries Co., Hiroshi Hosoya also works to develop a younger class of super technicians. He prowls a corner of the hangarlike pace filled with shafts of jet engines ound for customers that include Boeing Co. and Rolls-Royce Motor Cars Ltd. It will take all morning for his crew to coat the shafts with a layer of metal less than a hundredth of an inch thick. The slightest blemish could cause engines costing millions of dollars to malfunction. The 50-year-old Hosoya, who can discern surface variations most people can neither see nor feel, became a *supaa ginosha* this year, the only one at his plant. In 2003 he was named a *Meister*, a company designation shared by just 10 of the 900 employees at the facility. Today, his expertise is so great that even the company's top engineers come calling with tricky design questions.

The title is the shop-floor version of "Living National Treasures"

That's a big change from three decades ago when Hosoya joined the company as a high school grad. Back then, he learned the job by watching others. Now there's a formal ranking system that classifies everyone in the company as one of various levels up to sub-*Meister* and *Meister*, a nod to German engineering excellence. The company, though, offers no financial perks based solely on a worker's rank. "I got this far because I was passionate about the work I was doing in the factory," says Hosoya. "But I think the company should also offer higher salaries to *Meisters* as an incentive for others." The company says that given differences among factories, it would be difficult to give *Meisters* or *supaa ginosha* bonuses.

Of course, even some *supaa ginosha* must worry about automation. At a Mazda Motor Corp. plant in Hiroshima, super technician Yoshiaki Oda, now 64, once smoothed the welded joints on cars to a flawless finish. But he has since put down his sander because robots have replaced people in nearly all areas of car assembly, welding, and polishing.

Such cases, though, are the exception. Just ask Masuda and thousands of other *supaa ginosha* who outperform the machines every day of the week. ■

–With Hiroko Tashiro in Tokyo

GERMANY

TWEEDY BROWNE GOES GUNNING AT VW

It knocked off Conrad Black. Now it's after the head of Ferdinand Piëch

BY GAIL EDMONDSON

LOOK OUT GERMANY INC., here come the angry U.S. investors. In a development that takes globalization of investor activism to a new level, the powerful U.S. fund manager Tweedy, Browne & Co. is mounting an all out assault on Volkswagen's highest-ranking board member. Tweedy Browne, which played a big role in toppling Conrad Black from his perch as chief executive of media giant Hollinger International Inc. in 2003, is now going after Volkswagen's legendary supervisory board chairman, Ferdinand Piëch.

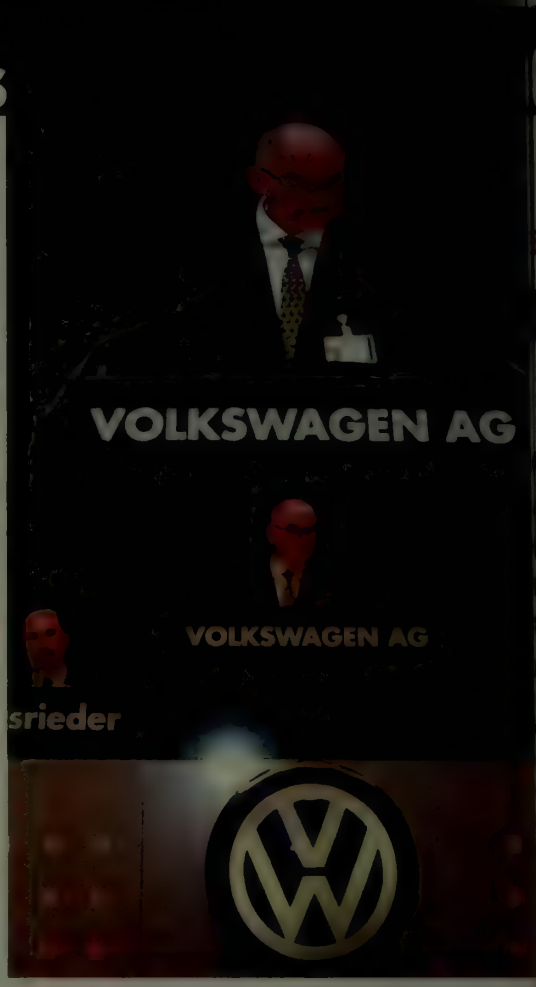
A former VW CEO and leading member of the family that controls German auto maker Porsche, Piëch wields big influence at VW since Porsche bought an 18.53% stake in the carmaker in October. That's a problem for Tweedy Browne, which worries Piëch will slow VW's much needed restructuring and use Volkswagen resources to subsidize Porsche operations. The U.S. investment firm also condemns Piëch's final years as VW CEO, when the groundwork was laid for VW's current poor performance. "He was a disaster for Volkswagen in the late 1990s," says Tweedy Browne Managing Director Thomas H. Schrager. "I want Piëch off the board. I want him to go away and enjoy his billions."

Tough talk for a firm that owns less than 1% of VW's shares and that's taking on a pillar of Germany's corporate elite. Not only does Schrager want Piëch out, he also wants to block Porsche from voting in its own CEO, Wendelin Wiedeking, and its chief financial officer as VW board members. Schrager insists such a move would effectively cede control of VW management to Porsche. But stopping Piëch will be difficult: Under German corporate law, to prevail at this spring's shareholder meeting, Tweedy Browne would have to garner 75% of the voting shares present at the meeting. Even Schrager concedes that the odds of that happening are slim.

LOBBYING FOR CHANGE

SO WHY BOTHER? Tweedy Browne figures that if it can gin up enough support, shareholder opinion will start to shift against Piëch and eventually thwart the sort of soft takeover of VW by Porsche that it fears. Tweedy Browne's hope: that Piëch will back off, ending the boardroom conflict and allowing VW Chief Executive Bernd Pischetsrieder to get on with cutting jobs and restructuring Europe's largest auto maker. That, plus a united board, would help boost VW's stock price, now around $55, toward Tweedy Browne's target price of $70. Schrager would also welcome an outright takeover offer for the rest of VW by Porsche that would put a premium on VW shares.

Other U.S. institutions are still on the fence. "There's plenty to be worried about at Volkswagen," says a fund manager with a large stake. "But I wouldn't be worried about this stuff." San Diego-based Brandes Investment Partners LP, with about a 10% stake in VW—by far the largest U.S. holder of VW—declined to comment. Other investors, meanwhile, still think Piëch will back the makeover that VW so badly needs.



LOOMING LARGE Piëch is backed by Porsche, which has a big stake in VW

Tweedy Browne has one ace to play: VW supervisory board member Christian Wulff, representative of the state of Lower Saxony, which owns 18.2% of the carmaker. Also highly critical of Piëch, Wulff commissioned a report by JPMorgan Chase & Co., which highlighted Piëch's possible conflict of interest and recommended that no Porsche executive sit on VW's board. Wulff, who was approached by Porsche's Wiedeking to resolve their differences, declined comment.

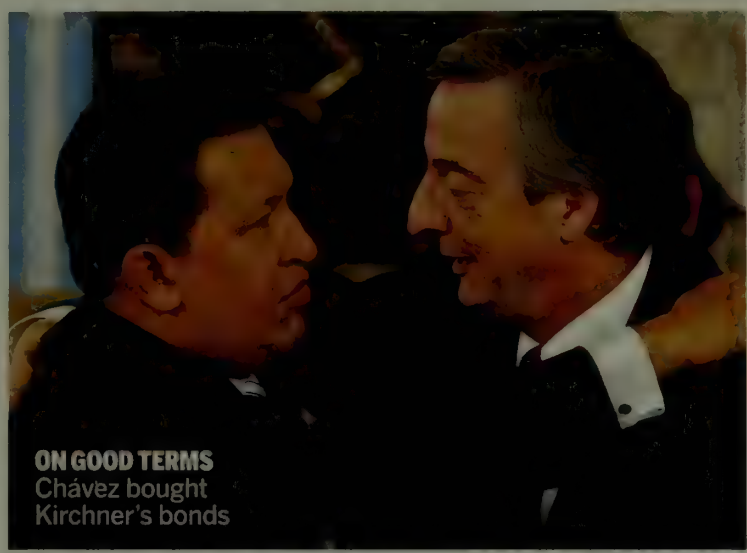
Piëch's maneuvers haven't helped. On Nov. 11 he backed the election of former union leader Horst Neumann as VW's new board member in charge of personnel. VW's five independent board members voted against Neumann, but the board's 10 labor representatives backed Piëch's choice. VW board member Gerhard Cromme, the respected head of Germany's commission on corporate governance, resigned in protest. "If Piëch has made an agreement with the unions to make fewer cuts in return for supporting him, the whole restructuring story at VW is gone," says Schrager.

Piëch isn't commenting. But Porsche's Wiedeking claims to support radical change at VW. And, clearly, so does Tweedy Browne. ■

EDITED BY ROSE BRADY

Chávez: Trading Oil for Influence

VENEZUELAN PRESIDENT HUGO CHAVEZ has been a thorn in Washington's side since taking office in 1999. He has threatened to interrupt vital oil shipments to the U.S. and claimed that President George W. Bush is planning an invasion to gain control over Venezuela's oil reserves, the largest outside the Middle East. Alarm bells went off recently when Chávez said he wanted to obtain nuclear technology from Argentina. But what worries Washington most is the way Chávez is spreading his strident anti-American message throughout the hemisphere, winning hearts and minds from Buenos Aires to the Bronx.



ON GOOD TERMS Chávez bought Kirchner's bonds

Flush with billions in windfall oil profits, Chávez, 51, is embarking on an ambitious campaign of petro-diplomacy that is rapidly increasing his clout in the region. U.S. officials have said they believe Chávez is channeling funds to the campaign of Bolivia's presidential front-runner, socialist Evo Morales, although Morales has publicly denied it. A self-described "anti-imperialist," Morales has pledged to end a U.S. program to eradicate cultivation of coca leaves, the raw material for cocaine, if he wins the Dec. 18 elections. Morales has also threatened to nationalize the natural gas industry—a move that could deal a blow to companies that have invested heavily there, including Exxon Mobil Corp.

"Castro with Oil"

BACKING FOR MORALES is just the latest of Chávez' oil-greased moves. Since the start of this year he has bought around $1 billion of Argentine government bonds. That earned him the gratitude of President Nestor Kirchner, who now could have an easier time ignoring restrictive International Monetary Fund rules. Chávez recently agreed to provide around 200,000 barrels a day of heavily subsidized oil to Cuba and 12 other Caribbean and Central American nations. Earlier this year, he inked a deal with Brazilian oil company Petrobrás to jointly build a $2.5 billion refinery near their shared border, and he has offered to buy some of Ecuador's debt to help shore up that politically unstable nation. "Chávez is a very influential, active leader with enormous resources who is trying to build an anti-U.S. coalition. If he succeeds, that would present enormous problems" in the region, says Michael Shifter, vice-president for policy at Washington's Inter-American Dialogue, a non-partisan think tank.

Chávez has even taken his public relations machine to the U.S. He ordered state-owned oil company Petróleos de Venezuela to provide through its U.S. subsidiary, CITGO Petroleum Corp., 12 million gallons of heating oil at 40% below market prices to needy residents in Boston and the Bronx.

> His anti-U.S. message is gaining traction in Latin America

No wonder some pundits refer to Chávez, who is a close friend and disciple of Cuban leader Fidel Castro, as "Castro with oil." After training guerrilla movements in Latin America in the 1970s and 1980s, Castro shifted to sending teachers and doctors to neighboring countries to spread his socialist message. But those countries were loath to alienate the U.S. government and investors, and they were turned off by Castro's repression of his own political opponents. But Chávez has managed to tap into growing discontent throughout Latin America, where citizens have lost faith in traditional political parties and feel that U.S.-advocated market reforms have benefited only the elite.

Strongman Syndrome?

WHAT'S WORRISOME is that Chávez, though democratically elected, has consolidated his grip on power by packing the Supreme Court, electoral council, and Central Bank with his followers. When dissident parties boycotted the Dec. 4 congressional elections to protest a possible breach in vote secrecy, pro-Chávez forces won all 167 seats. That will allow him to change the constitution to stay in office until 2021. "Chávez has an inflated sense of importance because he's had an unbroken series of successes," says Eduardo Gamarra, the Bolivian-born director of the Latin America & Caribbean Center at Florida International University. "The only thing that can slow him down would be a dramatic drop in the price of oil."

For Washington to counter Chávez' influence, it would have to start paying attention to the region after virtually ignoring it following September 11. "There has been a sense that Latin America can take care of itself, but Washington needs to start repairing the tattered relations," says Shifter. Instead of focusing U.S. aid so narrowly on drug eradication and security, Washington might boost its standing if it channeled more aid to programs to improve education, health-care, and justice systems in fragile Latin democracies. In the meantime, as long as oil prices stay high, Chávez' following is likely to grow. ■

–By Geri Smith in Mexico City

LANGE "It's time to blow it out and open 35 to 50 stores"

Pregnant with Possibility

Maternity wear designer Liz Lange has some big expansion plans

BY PALLAVI GOGOI

LIZ LANGE REFUSES to be pigeonholed. In 1997 as she was launching the first line of designer maternity wear, buyers at department stores warned that pregnant women wouldn't pay up for high fashion. But affluent women—later followed by celebrities such as Sarah Jessica Parker and Gwyneth Paltrow—flocked to Lange's stores.

In 2002, she jumped categories again, striking a deal with Target Corp. to design inexpensive maternity clothes. Her advisers said she would ruin her cachet, but business has grown 20% in each of the past three years, to an estimated $10 million. Lange herself is as likely to spend a day ringing up fabric mills as she is designing clothes. Her 45 employees need to be flexible, too: Many don't have job descriptions and everyone is expected to chip in with ideas and tasks in all departments. "'That's not my job,' is a phrase that just doesn't belong here," says Lange.

She'll need that sort of toughness as she gears up for an ambitious expansion. "It's time to blow it out and open 35 to 50 stores nationwide," says the animated Lange. She's pitching private equity firms for $25 million open stores in such cities as Dallas, Chicago, and San Francisco in '06. Lange also wants to expand into nursing wear and lingerie, and to enter the baby clothing and nursery furnishing market—all more competitive than maternity wear.

BUSINESSWEEK SmallBiz

Lange didn't set out to be a designer. She majored in comparative literature at Brown University, graduated in 1988, then snagged a job as an assistant editor at *Vogue*. At her next stop, with clothing designer Stephen DiGeronimo, she saw her pregnant friends squeezing into his nonmaternity clothes. The women "looked better just because the clothes were better designed," says Lange. "That was my 'Aha!' moment." Soon she was on her own, borrowing $50,000 from family to get going. "In my family, no one worked for other people," says Lange, whose father owned an insurance business.

She rented a 12-by-12-foot Manhattan office, then phoned a few women she thought might like her clothes. Soon, orders were pouring in from as far away as Saudi Arabia. The next year she moved into a store on the Upper East Side and hired her first two employees. "I was blown away with the incredible amount of dollars Liz was raking in in that 800-square-foot store," says Barry Ginsburg, a developer of high-end shopping outlets who invested in the company in 2000 and sits on its board of advisers.

That investment helped fund Lange's move to a 2,200-square-foot store on Madison Avenue in March, 2000. Six months later she branched out to Beverly Hills, then, in 2002, to upscale Greenvale, N.Y. Dresses and pants are priced around $150 each, and the average total sale is $1,200. Her Target line features $10 T-shirts and $23 dresses.

Lange says her company's flexibility will be vital to outmaneuvering competitors as she expands, but she concedes that some employees do better with defined boundaries. "There isn't a lot of handholding here," says Lange. She has learned to be wary when hiring people who have worked at larger, more structured fashion houses like Calvin Klein Inc. or Polo Ralph Lauren Corp., being sure to explain to designers, for example, that they may also be expected to select fabric or help with publicity. "You have to have entrepreneurial spirit here," says Jessica Gold, Lange's director of marketing. Gold started four years ago as Lange's assistant after graduating from college. "It's your motivation that will help you succeed here, because it's such a loose structure."

That might hold true for the folks Lange intends to hire to expand her company, too. She says she's looking for "top-tier management people who have expertise in store rollouts." And if they can fix a mannequin—well, that would be a plus. ■

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Around the beginning of the 20th century, society emerged from the late 19th century era of industrialization and made the transition into one of rapid mechanization. The ensuing trend toward automation was in response to the social needs of the times, and it was propelled by a strong focus on productivity and efficiency. This vast wave of industrialization and then automation culminated in today's IT revolution and accelerated globalization.

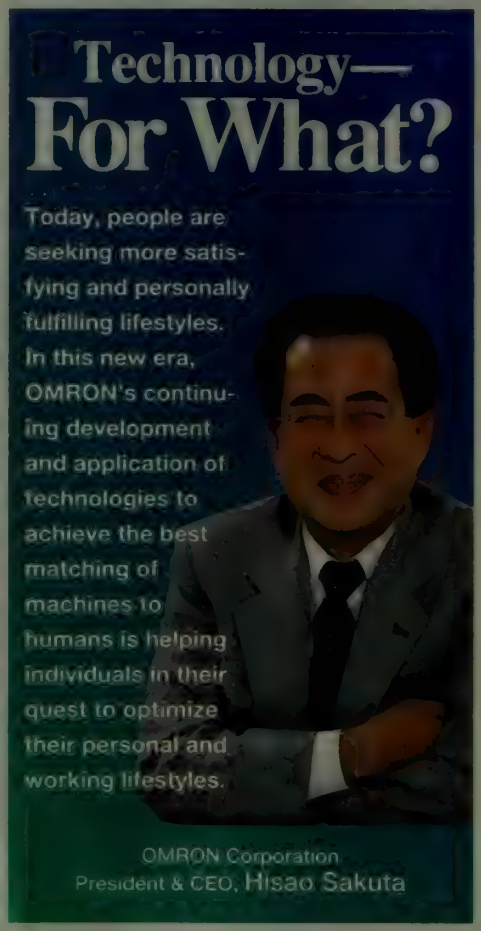
In recent decades though, social needs have evolved, and people are thinking more about the quality of personal and working lifestyles as well as more about the issues left behind by industrialization. Many have asked the question, "Technology—For What?" The answer seems to be that society today wants more emphasis on developing and applying technologies that reflect consideration for people's aspirations and feelings as well as technologies that put more emphasis on harmonizing relationships between machines and people, between human beings and nature, and between the drive for efficiency and the need for creativity.

At OMRON, however, we have always believed that a new era would come, the era of the "optimization society," when people are once again put first and where security, safety, the natural environment, and health have the highest priorities. Our company motto is best summarized by the words of our founder, Kazuma Tateisi, who wrote in 1959, "At work for a better life, a better world for all." He was convinced that companies should stand for something more than profit generation. They should look to social benefit as the compass for guiding their strategies and be proactive contributors to making a better life for all through their business activities.

Throughout its history, OMRON has focused on identifying social needs and creating products that promote security, safety, the environment, and health. In line with this company motto, virtually since its founding in Japan in 1933, OMRON has focused on being sensitive to and identifying social needs as well as creating products that contribute to fulfilling people's dreams for security, safety, a sustainable natural environment, and health. The optimization society now emerging will be characterized by more focus on the individual, and people worldwide will put more emphasis on attaining lifestyles that are both satisfying and psychologically fulfilling.

With social benefit as its compass, OMRON has created many value-added products over the years. A key theme for OMRON has always been assisting manufacturers in automating production processes to enhance product quality and create a workplace where the tasks that machines can do are left to the machines, allowing human beings to pursue more creative and exciting tasks.

OMRON's main businesses are industrial automation, electronic components, automotive electronics, social systems, and healthcare. In each area, the key theme is growing and developing by satisfying social needs.
OMRON has grown its businesses by anticipating the potential needs of society and developing products based on its core sensing and control technologies to meet those needs. Through continuing R&D in the fields of sensors, control systems, and human behavior, OMRON has perfected sensors that exceed the capabilities of human vision and control technologies that approach the level of human knowledge and judgment.



In our largest business, industrial automation, we are Japan's foremost manufacturer of control equipment for automating factory processes and make important contributions to improving productivity, profitability, and the quality of work life in many industries. To build this strong position in industrial automation, we have worked closely with our customers to explore new possibilities and bring their ideas to life through socially responsible manufacturing.

At OMRON, our approach is always to bring our customers the latest thinking in sensing and control to help them be quicker, more efficient, and smarter. To meet the needs of manufacturers who want to raise productivity, improve quality, and lower failure rates at all their plants around the world as well as consumers everywhere for high quality products, OMRON has developed its Quality Lifecycle Management (QLM) solutions.
In implementing these solutions, we work closely together with individual customers to develop "smarter" inspection systems that draw on the experience of seasoned experts within their workforce. As in the case of inspection experts who have the uncanny ability to detect flaws simply by "listening" to machinery, this experience is often difficult to share. By quantifying and modeling the data on which these human judgments are based, Omron's QLM solutions allow its customers to harness this expertise and utilize it throughout their production centers worldwide. For example, the sensors and microphones in our abnormal sound detection system, Signarc, can accurately pick up sounds and vibrations on a production line and cross-reference them with past data to detect defective products. What is more, this is just one example of how our QLM solutions can go beyond fault detection to provide data about the extent and causes of defects that can be fed upstream into the initial stages of design and development to help prevent defects from occurring throughout the whole product lifecycle.

We at OMRON think the answer to the question posed in the title "Technology—For What?" is that technology should satisfy social needs and contribute to the creation of products that enhance security, safety, the environment, and health. Why? First, because in the "optimization society" people worldwide will put more emphasis on attaining better life and work styles. But also because it is just good business—for all our stakeholders. Good evidence of this is that for the year ended March 31, 2005, OMRON's consolidated net sales grew 4.1%, to US$5,687.7 million, operating income expanded 9.2%, to US$524.4 million, and return on equity rose to 10.4%.

More information on all aspects of OMRON's activities is available at
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	Dividend Growth Fund	★★★★	10.98%	2.97%	9.25%
	Equity Income Fund	★★★★	12.08%	7.39%	10.88%
	Personal Strategy Growth Fund	★★★★★	15.30%	5.29%	10.06%
	Spectrum Growth Fund	★★★★	18.27%	2.91%	9.47%
	Value Fund	★★★★	13.70%	7.58%	11.87%
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	Short-Term Bond Fund	★★★★	1.74%	4.60%	5.00%
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		As of 10/31/05	As of 9/30/05		

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*The Overall Morningstar Rating™ is derived from a weighted average of the performance figures associated with a fund's 3-, 5-, and 10-year (if applicable) Morningstar Rating™ metrics. Balanced and Capital Appreciation were rated among 704, 704, 528, and 220 moderate allocation funds; Dividend Growth, Personal Strategy Growth, and Spectrum Growth among 1,237; 1,237; 938; and 327 large blend funds; Equity Income and Value among 861, 861, 572, and 269 large value funds; GNMA among 309, 309, 244, and 153 intermediate government funds; Short-Term Bond among 252, 252, 186, and 104 short-term bond funds; and Spectrum Income among 112, 112, 99, and 57 multisector bond funds for the overall rating and the 3-, 5-, and 10-year (if applicable) periods ended 10/31/05, respectively.***

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The Big Picture

After a year of hurricanes and oil spikes, optimism is the word for 2006

STOCKS >> P. 60
Following two years of downward pressure and sideways markets, the bulls are ready to run

FEARLESS FORECASTER >> P. 62
How UMB Asset Management's William Greiner beat the other 66 strategists in last year's survey

MARKET SURVEY >> P. 64
Wondering where the indexes are headed in '06? Here's what the pros see on the horizon

GURUS >> P. 66
Our roundtable with stockpicking stars reveals their secrets—and strategies

THE ECONOMY >> P. 70
Expect continued strength in the coming year, unless the housing or oil markets jump the rails

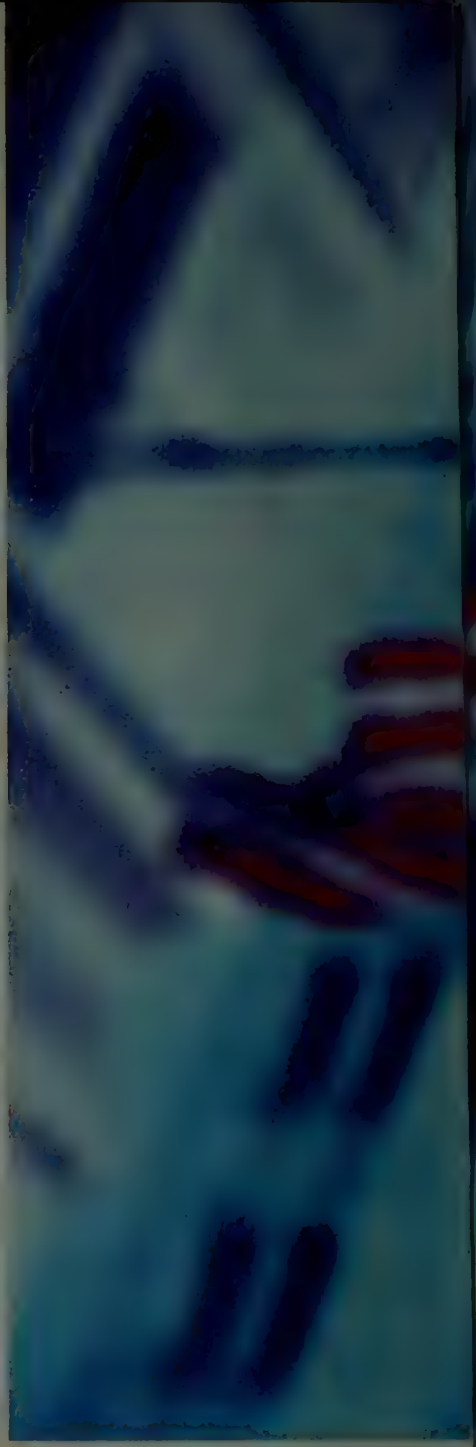
CALLING IT RIGHT >> P. 72
Verizon's Constantine Soras came closest to pegging the shock-tossed economy of 2005

ECONOMIC SURVEY >> P. 74
Our roster of dismal scientists take their best shot at where the maturing boom is headed

MARK CAMPBELL

The Bulls: Pawing and Snorting

Rate hikes and oil prices are easing, and profits remain healthy. That bodes well for many stocks. BY MARA DER HOVANESIAN



MARKET BULLS ARE itching to run. They say U.S. stock indexes will not only hit a new high over the next 12 months but also will break their all-time record of five years ago, the peak of the longest-running bull market in history. U.S. business, the bulls argue, will clock in its fourth straight year of strong profit growth, and the economy will grow at a robust clip of 3% or more. Oil prices that reached $70 a barrel this summer will ebb, and inflation worrywarts will be silenced, at least for now. Oh, and the bottom won't fall out of the housing market, either.

Sound far-fetched? Maybe it isn't. If the woes of the auto and airline industries, a Category 4 hurricane, surging oil prices, and increasingly indebted consumers haven't yet derailed the markets, what on earth will? Even a dozen Federal Reserve interest rate hikes since mid-2004 haven't put the kibosh on the economy, which grew at a stronger-than-expected 4.3% rate in the third quarter. Sure, the markets have struggled to process often conflicting signals and, as a result, have been stuck in a narrow trading band for two years. So how can the bulls be so sanguine? "Everyone complains about the stock market going sideways, but sideways is in fact an incredible victory," says Ronald P. O'Hanley, vice-chairman of Pittsburgh-based Mellon Financial Corp.

The Bull Case

Despite worries about the economy and interest rates, there are lots of reasons to be upbeat about U.S. stocks in 2006:

- Overflowing **corporate cash** coffers will stoke IT and other capital spending as well as merger activity
- Trading at a p-e ratio of about 16 based on 2006 earnings estimates, S&P 500 **stocks are undervalued**
- Inflation is in check, interest rates are still historically low, and the **end of rate hikes** is in sight
- Despite a slowdown, **corporate earnings** are expected to rise quite strongly
- High energy prices, rising interest rates, catastrophic hurricanes, and sluggish home sales haven't derailed **resilient consumers**

OPTIMISTS APLENTY

GOOD POINT. Thanks to the recent rally, the Standard & Poor's 500-stock index and the NASDAQ Composite Index were up 4% and 3.7%, respectively, through Dec. 9, although the momentum was barely enough to push the Dow Jones industrials into positive territory. Yet even that lackluster outcome is seen as a harbinger of good returns. With the S&P trading at a price-earnings ratio of about 16 based on estimated 2006 earnings, many investment pros think the market is undervalued. "We're bullish," says David S. Spika, an investment strategist at Westwood Holdings Group

n Dallas. "The market is relatively cheap."

Spika has plenty of company among the Wall Street strategists we polled for *BusinessWeek*'s 34th yearend investment outlook. The consensus pegs the Dow closing above 11,500 next year, the S&P at 1,347, and the NASDAQ Composite at 2,428—roughly 7% gains from here. Our forecasters say they're optimistic because two major headwinds for equities—rate hikes and oil price spikes—look to be easing off. As always, an important driver in the stock market will be profits, and they're still holding up well, too. By yearend, S&P 500 stocks will have reported about $77 in operating earnings per share—a 13% rise, and the 15th quarter in a row of year-over-year double-digit growth. Howard Silverblatt, an equity-market analyst at S&P, says his group expects an additional 11.4% increase in

Market mavens are predicting a surge for both large-cap and technology stocks

2006. "It'll downshift just a little bit," agrees Bob Baur, managing director, Principal Global Investors LLC. "But there's nothing wrong with that. You can't expect 20% profit growth forever."

Companies have been sharing that wealth. In 2005 they spent a record $300 billion on share buybacks and another $200 billion on dividend payments, according to Silverblatt. That trend is expected to stay intact, so dividend-paying stocks are still a good bet.

But next year companies are expected to do more with their cash hoards, which amount to a total of about $635 billion for the companies in the S&P 500. Analysts expect that, either by choice or under pressure from newly emboldened activist investors and hedge funds, many will start spending more of the money. That spending will be directed toward technology, equipment, and business services, and may fund a wave of mergers and acquisitions. "I think this will be more of a company-led expansion instead of one led by consumers," says Lincoln Anderson, chief economist at Boston's LPL Financial Services. A brisk market for deals (page 114) is forecast to trigger gains in banking, asset management, and brokerages, as well as in airlines, utilities, and software.

Of course, certain developments could spoil the bulls' rosy scenario. The Fed

could tighten too much. Energy prices could spike again. Certainly, concerns about housing and consumer spending will persist, especially as bankruptcies rise and real estate starts to cool. As a result, many investment pros suggest avoiding retail and consumer durable stocks. In general, Joseph McAlinden, chief investment officer of the global equity group at Morgan Stanley Investment Management (a self-described *taurus antiquitus*, or old bull, who expects the market to exceed the all-time high reached in the year 2000) still suggests caution. He anticipates a 10% to 15% correction sometime in the second or third quarter and then a surge. "[Stick to] higher-quality companies that are less likely to have earnings clobbered during a downdraft," he says, such as General Electric and defensive stocks in the pharmaceutical and consumer staples industries.

In fact, plenty of market mavens expect such large-cap stocks to do better after being left in the dust by small caps for six years. Wayne C. Stevens, chief investment officer of Chicago's Dearborn Partners LLC, says large caps start to perform better when real returns on 90-day Treasury bills reach 2%. (They were negative until October, 2004.) "We've just hit the inflection point," he says.

UNEASE ON MAIN STREET

GROWTH STOCKS, TOO, are expected to start outperforming value stocks. Tech could likely be the big winner. Richard H. Driehaus, chief investment officer of Chicago's Driehaus Capital Management Inc has doubled his stake in tech stocks in th past six months, to 20% of the Driehau Small Cap Growth portfolio. He favors N advertising, sales, and infrastructure com panies, such as 24/7 Real Media, Getty Im ages, Digital River, and Google.

Unlike the pros, most ordinary investor are downbeat. Many are worried abou their paychecks, the value of their home and their stock portfolios. In fact, they're s glum that, according to Citigroup Inc.' Panic/Euphoria model for consumer senti ment is at its most pessimistic since 1994. renowned stock guru Sir John Templeto was right in saying that bull markets ar born of such pessimism, the 2006 stoc market outlook may indeed turn out rosie than it looks. ■

FEARLESS FORECASTER

The Sage Of Kansas City

Of the 67 investment strategists surveyed for *BusinessWeek*'s 2005 Fearless Forecast of the equity markets, William Greiner took the gold. Predictions from the chief investment officer at UMB Asset Management in Kansas City, Mo., were just 0.8% above the Dow Jones industrial average, 0.6% off the Standard & Poor's 500-stock index, and less than 0.1% higher than the NASDAQ Composite. The race was close: Nearly half the lot came within 5% overall.

How did Greiner win? He expected that the negatives of rising interest rates and slowing earnings growth would be offset by robust capital spending and strong export growth. "All these factors combined led us to believe the market was going to be up this year, but not by a lot," says the 51-year-old Kansas native and an economics graduate of Washburn University in Topeka.

Although his name is the one that goes on the forecast, Greiner credits his colleagues who assist him in crunching the data. It also helps that he has 27 years of investment experience—the past six at UMB. Before joining UMB, Greiner worked at Northern Trust in Chicago. He also attributes some of his smarts to his hobby—riding motorcycles. "When I'm on the bike, I'll ride aggressively and have to focus," he says. "It cleanses the system."

For 2006, Greiner anticipates a Dow finish of 11,700, the S&P at 1,340, and the NASDAQ at 2,350. Those are advances of 8.5%, 6.4%, and 4.1%, respectively. "While our numbers look tame, there are going to be trading opportunities" during the year, he says. The trend is up, but rising interest rates, slowing profit growth, and angst about the housing market are sure to help generate volatility in the stock market.

Will the Fearless Forecast produce an unprecedented two-time champ next December? Runner-up C. Kim Goodwin—last year's winner—nearly was one this time around. She was hot on Greiner's heels, but missed the NASDAQ by 1.9%. This year when BlackRock Financial Management acquired Boston's State Street Research & Management Co., Goodwin decided to go independent. A corporate board director for Akamai, she's forecasting a 2006 Dow finish of 11,850, 1,456 for the S&P, and 2,563 for the NASDAQ. One thing's for sure: With Goodwin more bullish than Greiner, there's no way the two will repeat their neck-and-neck finish in 2006.

–By Bremen Leak

GREINER He expects a Dow of 11,700

The Winner's 2005 Predictions

	Dow Jones Industrial Average	Standard & Poor's 500-Stock Index	NASDAQ Composite Index	Russell 2000 Index**
GREINER'S FORECAST	10,900	1,265	2,250	655
ACTUAL LEVELS*	10,811	1,257	2,252	683

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Fearless Forecasts from the Pros

BY ANNE TERGESEN AND BREMEN LEAK

The *BusinessWeek* Market Survey

NAME / FIRM	DOW JONES INDUS. AVG. MIDYEAR	DOW JONES INDUS. AVG. YEAR END	S&P 500 YEAR END	NASDAQ COMPOSITE YEAR END	RUSSELL 2000 YEAR END	ASSET ALLOCATION* U.S. STOCKS	INTL. STOCKS	U.S. BONDS	CASH	FAVORITE STOCK SECTOR	FAVORITE STOCK
ELAINE GARZARELLI Garzarelli Capital		14150	1635	2900	875	100	0	0	0	Technology	Motorola
TOBIN SMITH ChangeWave Research	11750	12500	1430	2560	751	40	40	0	0	Technology	Apple
PETER TRAPP Bifrost Partners	12100	12500	1460	2750	860	35	25	10	10	Technology	Emrise
JOSEPH LIRO Stone & McCarthy Research Assoc.	11500	12400	1450	2575	800	50	20	15	10	Technology	General Electric
CHARLIE CRANE Scotsman Capital Management	11750	12360	1425	2595	750	90	0	0	10	Technology	Gap
ROBERT BAUR Principal Global Investors	11498	12200	1405	2700	790	50	20	20	5	Health care	
MARK ELENOWITZ TriPoint Capital Advisors	11200	12200	1425	2663	801	64	13	12	6	Technology	IDT Corp.
CHARLES MAYER Pioneer Investments	11125	12200	1400	2400	725	65	15	15	5	Ind. cyclicals	
JAMES SWANSON MFS Investments	11900	12110	1458	2745	700	55	25	15	5	Health care	Wyeth
STUART T. FREEMAN A.G. Edwards & Sons	11750	12100	1400	2470	730	71	6	19	4	Cons. staples	Capital One Financial
ED YARDENI Oak Associates	11800	12080	1410	2700	850	60	20	10	0	Energy	Boeing
LINCOLN ANDERSON LPL Financial Services	11350	12000	1415	2584	725	75	5	15	5	Technology	
CHRISTOPHER CONKEY Evergreen Investments	11000	12000	1425	2600	755	50	20	17	7	Technology	Dobson Communications
JIM CRAMER TheStreet.com/CNBC	11500	12000	1400	2500	800	85	10	0	5	Technology	UnitedHealth Group
ARVIND SACHDEVA Victory Capital Management	11750	12000	1375	2550		62	0	35	3	Technology	Newmont Mining
LIZ ANN SONDERS Charles Schwab	12200	12000	1385	2930	720	45	20	25	10	Technology	Hewlett-Packard
TIMOTHY SWANSON Natl. City Private Client Grp.	11500	12000	1400			51	12	35	2	Health care	Zimmer Holdings
JOHN REGAN Americal Investment Strategies	11530	11983	1398	2538	773	65	15	0	5	Technology	UnitedHealth Group
ROBERT MORRIS Lord Abbett	11193	11920	1400	2570		40	30	25	5	Ind. cyclicals	Microsoft
DAVID KATZ Matrix Asset Advisors	11370	11915	1375	2525	726	70	5	15	10	Technology	Symbol Technologies
ZACHARY KARABELL Fred Alger Management		11900	1370	2440	750						
TOBIAS LEVKOVICH Citigroup		11900	1400		750	60	0	35	5	Technology	Time Warner
GARY TAPP SunTrust Robinson Humphrey	11348	11894	1394	2577	774	55	20	15	5	Financials	Brunswick
C. KIM GOODWIN Independent	11300	11850	1456	2563	775	50	25	10	5	Cons. durables	
HARVEY HIRSCHHORN Bank of America	11800	11850	1400	2550	740	53	11	33	3	Technology	
JEFFREY KLEINTOP PNC Advisors	11400	11850	1375	2500	715	52	18	25	5	Technology	Texas Instruments
VINCENT GALLAGHER Needham	11400	11825	1385	2500	770	50	20	20	10	Services	Bright Horizons Fam. Solns.
CHRIS PIROS Prudential Investments	11160	11810	1375	2415	735	45	15	35	5	Health care	
DOUGLASS BERMINGHAM Jesup Lamont	11200	11800	1380	2545		55	15	0	5	Technology	AltiGen Communications
JASON TRENNERT ISI Group	11300	11800	1380	2475	730	65	10	20	5	Technology	Cisco Systems
KEITH WIRTZ Fifth Third Asset Management	11578	11795	1380	2550	730	48	15	30	2	Technology	Electronic Arts

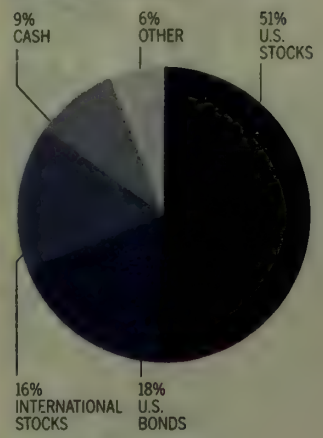
Here's something to look forward to: Stocks are likely to deliver greater gains in 2006 than they did this year, according to the 76 strategists we polled. The gurus foresee a 7.2% gain for the Dow Jones industrial average in 2006, with the S&P 500 rising 7%, and the NASDAQ Composite gaining 7.6%. The technology sector is our prognosticators' overwhelming favorite for 2006. Strategists are listed according to their yearend Dow forecasts, from the most bullish to the most bearish.

KEITH WIRTZ Fifth Third Asset Management	11578	11795	1380	2550	730	48	15	30	2	Tec funchary	Electronic Arts
ROBERT STOVALL Wood Asset Management	10820	11750	1380	2395	780	40	35	10	15	Cons. staples	Tootsie Roll Industries
ROGER DeBARD iGlobal Capital	11550	11748	1378	2478	740	43	7	15	30	Technology	Sherwin-Williams
WILLIAM GREINER UMB Investment Advisors	10200	11700	1340	2350	660	43	8	43	6	Health care	Microsoft
THOMAS McMANUS Banc of America Securities	10700	11700	1335	2450	675	55	0	20	25	Cons. staples	Nike
ALLAN RONESS ASR Corporate Consultants	11400	11700	1380	2700	715	65	20	0	0	Health care	Estee Lauder
ROGER IBBOTSON Ibbotson Associates	11308	11697	1362	2489	748	44	16	30	10		
JOSEPH BATTIPAGLIA Ryan Beck	11225	11650	1350			62	13	8	12	Health care	Microsoft
IVAN GEFEN vFinance	11250	11650	1380	2460	765	40	20	20	10	Technology	
ARTHUR HOGAN Jefferies	10553	11600	1341	2440	710	60	10	15	15	Energy	Scientific Games
CHRIS SHELDON Mellon's Private Wealth Mgmt. Grp.	11250	11600	1350	2425	705	35	15	35	0		
ROD SMYTH Wachovia Securities	11200	11600	1350	2500	700	45	20	25	5	Technology	
JEFFREY TYLER American Century Investments	11500	11600	1330	2400	720	50	10	30	8	Technology	
JAMES WONG Payden & Rygel	11100	11600	1270	2500	650	20	30	25	5	Energy	America Movil
DORSEY FARR Wilmington Trust	11245	11580	1340	2400	725	25	25	15	5		
MARK JORDAHL First American Funds	11245	11575	1360	2520	720	46	22	30	0	Technology	Freescale Semiconductor
JOHN CLARKE H.C. Wainwright	11280	11562	1350	2422	727	45	15	15	15	Technology	Delcath Systems
SAM STOVALL Standard & Poor's	11200	11525	1360			45	20	20	15	Health care	St. Jude Medical
BRUCE BITTLES Robert W. Baird	10500	11500	1350	2300	700	45	10	35	10	Energy	
LINDA DUESSEL Federated Investors	10600	11500	1325	2345	670	43	20	33	0	Energy	
GEORGE JACOBSEN Trevor Stewart Burton & Jacobsen	11200	11500	1320	2400	735	70	0	10	20	Health care	Eli Lilly
DAVID JOY RiverSource Investments	11750	11500	1300	2350	700	30	40	20	10	Energy	Valero Energy
MIKE VOGELZANG Boston Advisors	11500	11500	1320	2360	690	45	5	40	10	Ind. cyclicals	Encana
CLARE ZEMPEL Zempel Strategic	11250	11500	1375	2525	750	60	20	15	5	Services	Dow Chemical
HUGH JOHNSON Johnson Illington Advisors	11050	11450	1280	2370	670	80	15	0	5	Technology	General Electric
WENDELL PERKINS Johnson Asset Management	11105	11370	1314	2356	695	38	42	10	7.5	Technology	Sony
DANIEL DEKTAR Smith Breeden Associates	11100	11360	1315	2340	702	25	25	20	10		
SUBODH KUMAR CIBC World Markets	11200	11350	1300	2600	685	43	26	21	8	Technology	
ASHER PLAUT Brill Securities	11200	11300	1275	2150	695	60	10	20	10	Technology	Arena Resources
JACK ABLIN Harris Private Bank	10290	11290	1305	2280	645	30	30	30	10	Health care	WellPoint
RICHARD DRIEHAUS Driehaus Capital Management	11600	11200	1320	2375	715	50	20	15	10	Technology	Focus Media Holding
WARREN BAGATELLE Loeb Partners	10950	11150	1365	2365	750	69	0	15	6	Health care	Pfizer
GAIL DUDACK SunGard Institutional Brokerage	11600	11100	1350	2400	630	65	0	15	20	Ind. cyclicals	
BARRY HYMAN Ehrenkrantz King Nussbaum	11600	11100	1280	2300	690	50	10	20	15	Health care	
DAVID BIANCO UBS Securities	11500	11000	1250			45	25	20	10	Ind. cyclicals	
JEFFREY KNIGHT Putnam Investments	11600	11000	1280	2370	630	20	20	20	5	Energy	HS Group
JOHN ROBERTS Hilliard Lyons	11180	10625	1220	2190	645	50	20	10	15	Health care	Pfizer
RALPH ACAMPORA Knight Capital Group	9000	10500	1170	2160	613					Technology	Akamai Technologies
BERNIE SCHAEFFER Schaeffer's Invest. Research	10350	10000	1160	1900	620	40	10	15	25	Financials	Moody's
BARRY FREEMAN HPC Capital Management	10900	9900	1150	2050	640	40	40	0	10	Health care	OneTravel Holdings
LAWRENCE McMILLAN McMillan Analysis	11450	9730	1125	1920	565	50	10	0	40	Health care	Pfizer
MICHAEL PAINCHAUD Market Profile Theorems	9500	9000	1150	1800	580	20	20	0	40	Cons. staples	Anheuser-Busch
BARRY RITHOLTZ Maxim Group	11800	6800	880	1400	540	15	30	25	10	Services	iShares COMEX Gold Trust
CONSENSUS	11250	11556	1347	2428	717	51	16	18	9		

*Asset allocations do not total to 100 in some cases because of allocations in other catagories, such as gold, REITS, hedge funds, and non-U.S. bonds

	HIGH	LOW	AVG.
Dow Jones Industrial Average	14150	6800	11556
S&P 500	1635	880	1347
NASDAQ Composite	2030	1400	2428
Russell 2000	875	540	717

CONSENSUS ASSET ALLOCATIONS



MOST POPULAR SECTORS

	NUMBER OF RECOMMENDATIONS
Technology	32
Health Care	17
Energy	7
Industrial Cyclicals	5

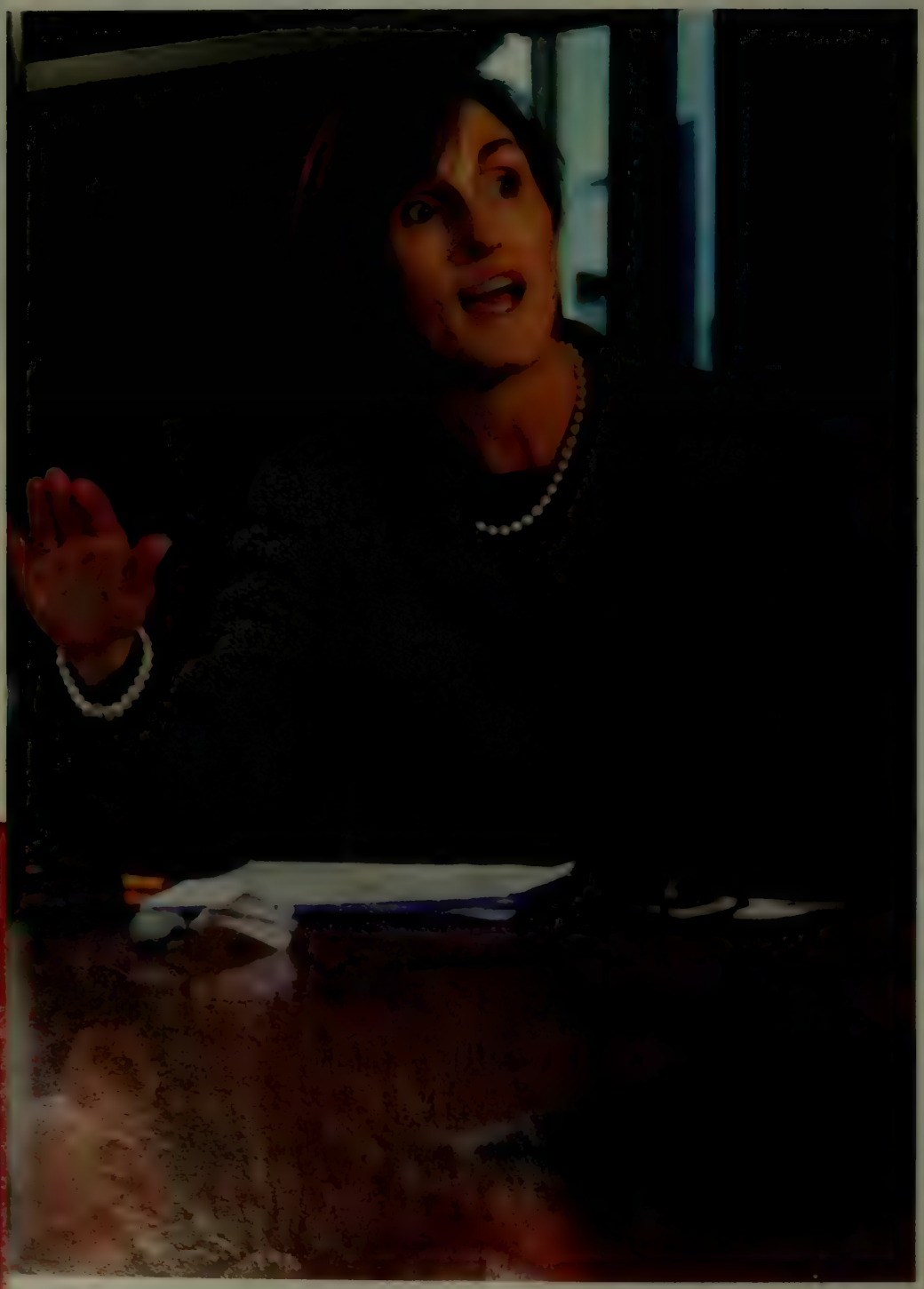
MOST POPULAR STOCKS

	NUMBER OF RECOMMENDATIONS
Microsoft	3
Pfizer	3
General Electric	2
UnitedHealth Group	2

CHART BY LAUREL DAUNIS-ALLEN

Star Stockpickers Share Their Secrets

Whether the Fed overshoots or the broadband revolution moves into full swing, these pros have a way to play it. BY DAVID HENRY



EVEN IN THE BEST O times, smart stockpickin has been the way to beat th market. Just look at the re sults from the panels of ex perts we've gathered th past three years. Last year' group made 20 picks that delivered a tota return of 13.4%, five points better tha Standard & Poor's 500-stock index, ac cording to FactSet Research Systems, Inc The two earlier groups beat the marke with returns of 23.8% and 30.7%.

This year's panelists offer choices fo most every appetite. Richard Bernstein Merrill Lynch & Co.'s chief U.S. strategist recommends stocks that pay hefty divi dends. Catherine D. Wood, who manage $15 billion in growth stocks for Allianc Capital Management LP, aims for bi gains from volatile tech stocks. David B Scott, senior vice-president at Chase In vestment Counsel, seeks earnings growth from more cautious plays. David J Williams, portfolio manager of U.S. Trust Corp.'s Excelsior Value & Restructuring Fund, offers an eclectic mix of mostly beaten-down shares that he thinks are ready to spring back to life. When the Group assembled in early December, the S&P 500was at 1,249. Here are highlights of the discussion:

Catherine D. Wood

COMPANY/SYMBOL	PRICE*	P&E RATIO**
AMAZON.COM AMZN	48.74	51
GIVEN IMAGING GIVN	25.77	48
JUNIPER NETWORKS JNPR	22.55	25
SILICON LAB. SLAB	39.16	32
XM SATELLITE XMSR	29.04	NA

Panelists, or their firms, have financial interests in many of these stocks.

* As of Dec. 9 ** Based on forecast earnings for fiscal 2006
Data: Bloomberg Financial Markets I/B/E/S

Are stocks going up or down in 2006?

BERNSTEIN Stocks won't do much. Returns are going to be muted—low single digits, if that. The big reason is capital is so plentiful and has pushed up prices already. We see the S&P in 12 months at 1,225, about where it is now. With dividends, you'll pick up a couple percent. You can do better by picking the right stocks and dividend payers. The risk is that the Federal Reserve hikes rates too high. The Fed has never known exactly when to stop tightening.

WILLIAMS Rich, you said the same thing last year, and you were right. But I'm still much more bullish. I see the massive liquidity, too, but that is good for consumers and for corporations. It will pay for dividends, share buybacks, and takeover premiums. The economy is growing nicely here and overseas. Inflation is low. I see the S&P going up about 100 points, to 1,360, about 9%, and that's being conservative.

SCOTT It is time to be cautious. The Fed is going to have to continue to raise rates into 2006 and may well overshoot. Inflation is going to put pressure on profits. To pick a number, the S&P will be at 1,180, down about 5%, if not more. I'm looking for defensive stocks from companies that will not suffer if the economy slows, like consumer staples and health care.

WOOD I'm definitely the most optimistic one on this panel. This worry about the Fed overshooting is already priced into the market. Inflation is going to be lower than people anticipate. Energy and other commodity prices are going to come down a lot more because demand worldwide is less than expected and supply is rising quickly. That will lift profits. This is the time to buy earnings growth. That's why I'm overweight in tech and consumer discretionary stocks, such as some Internet retailers and media companies.

Cathie, what are good consumer stock picks that reflect your optimism?

WOOD Amazon.com is one. They've had some disappointments, but this is a true growth story and a play on the broadband revolution. With e-commerce taking off, you want to be in a stock like Amazon. The issue is that their earnings have not been going up, but that's because they're investing in the business. It is going to be tremendous as these investments pay off. I like XM Satellite Radio. Its competitor, Sirius, is getting more attention because it hired Howard Stern. But XM has better technology and 6 million subscribers, twice as many as Sirius.

WILLIAMS XM is my second-largest holding, but I wouldn't put it on my list of best picks. The market has put high expectations in the stock price. What bothers me most is that technology time and again has proved to be a commodity. There's going to be all kinds of competition. Why would an investor pay up for it? That said, I do like satellite broadcaster EchoStar Communications. The stock is cheap, around 26, even though its franchise is worth at least 35 a share. The CEO owns half the stock and has a history of creating value.

I'm not a big fan of retailing, but look at TJX Companies. It has a great franchise in discount pricing with Marshalls and T.J. Maxx stores. Their earnings have been flat this year, which is highly unusual for them. They've got new management and restructuring opportunities. It is a 30 stock trading around 23.

What do you think of tech stocks?

WOOD Some of them could really take off. We own twice as much tech as is in the S&P. One is Juniper Networks Inc. The stock is down 15% this year. It is essentially an Internet backbone builder. Broadband has passed 30% household penetration and is accelerating. The Internet bubble held a kernel of truth, just 5 to 10 years too early. Well, we are in year five and we're about to take off with stocks like this.

SCOTT I'm leery. Big info-tech stocks are becoming more tied to ups and downs of the economy. They're not consistent. You're better off with companies that use tech to increase productivity, like UnitedHealth Group Inc., the HMO, which uses IT to contain costs.

WOOD People said the same thing about tech in the mid-'80s, right before Microsoft emerged and PCs took off.

SCOTT But for the stocks to move, you need leadership from large-cap issues in the sector. At this moment those are Internet content, search, and advertising companies, which have already run up.

WOOD Juniper could still do just that in the snap of your fingers. It is growing about 35%. It is in a beautiful position with the right technology to enable this broadband revolution, to enable a Google. Another candidate is Silicon Laboratories, which makes special chips that combine analog and digital for telecom and microcontrollers. We think it could earn $1.70 next year and take off. Wall Street's estimate is just $1.25.

SCOTT I do see one unusual tech opportunity in Motorola. They're big and well-positioned internationally and with new products. The stock is relatively inexpensive at 18 times earnings and potential growth of 20%.

David Scott, what are your cautious picks in health care?

SCOTT Besides UnitedHealth, I like Teva Pharmaceuticals. It is a global generic

Richard Bernstein

COMPANY/SYMBOL	PRICE*	P&E RATIO**
BELLSOUTH BLS	27.61	14
CONSOLIDATED EDISON ED	45.46	15
MERCK MRK	29.13	12
PROCTER & GAMBLE PG	57.33	22
XEROX XRX	14.53	14

"XM has better technology and 6 million subscribers, twice as many as Sirius," says Wood

drugmaker poised to take advantage of drugs coming off patents. The stock is reasonably priced, and the company is consolidating with IVAX.

WILLIAMS David, speaking of overpriced, why would anyone pay 20 times earnings for UnitedHealth? It's really an insurance company.

SCOTT It is one of the very few companies that consistently produces 18%-to-22% earnings growth. Yes, it does it by consolidation, but that strategy has a ways to go.

WILLIAMS I think the consolidation story is already far along. It's overpriced.

WOOD There are some tech-oriented, early-stage health companies with open-ended opportunities. I like Given Imaging. They have a pill-cam, a tiny camera you swallow instead of going through a colonoscopy. The potential market is huge. The hurdles are changing medical practice and standardizing reimbursement, but those are already in the stock.

BERNSTEIN There's a totally different opportunity in Merck, the big pharmaceutical maker. Everybody hates it because of the litigation risk. That's like the tobacco stocks, which worked well over time. Merck's dividend yield is 5%, which is important in a flat market.

Can investors still make money with energy stocks?

WOOD We've pulled out. They were our biggest portfolio. Oil is about 59, but it could go to the low 30s. We don't want to be in the stocks while that is going on.

BERNSTEIN We're neutral. Pure speculation has been driving commodity prices the past 18 months. Our forecast is that oil will be 40-something in 12 months.

WILLIAMS If oil goes down, chemical feedstock costs will go down, and Celanese will be a winner. It is a bargain at seven times earnings. They've restructured to cut costs. Management is good and has executed well.

SCOTT I like Burlington Resources because they produce natural gas, which is in tight supply domestically. [As we went to press, Burlington jumped on a takeover bid. Scott offered a similar gas pick instead, XTO Energy. Trading at 45, it should go to the mid-50s, he said.]

WILLIAMS Consol Energy is my only pick that is not beaten down. It's a coal company and locking in prices with long-term contracts. Also, they've got a methane gas business that could be split off. The stock's worth probably 90, so it is still cheap at 63. Coal and gas are relatively safe as energy stocks go.

What are some other safety stocks?

BERNSTEIN I own Procter & Gamble. It's not as defensive as a food or supermarket stock. It has some broader appeal in growth potential overseas.

SCOTT PepsiCo will do well regardless of the economy, and it is a growth story. Its opportunity is international. Now most of their profits are from North America. They have an edge in noncarbonated beverages, such as water and sports drinks, with Aquafina and Gatorade.

BERNSTEIN Some people would call Consolidated Edison a boring utility, but not me. It yields 5% and has strong cash flow. You could get some price gain, too. BellSouth yields 4%. It is part of the most hated stock group in the entire world, large-cap U.S. telecom. Their earnings are growing with reasonable certainty, just not as much as people thought five years ago.

WILLIAMS Rich, chasing yield is one of the biggest mistakes I made this past year. It is tough for companies that don't have good earnings growth to increase dividends. You've got three big uglies here on your list in BellSouth, Con Ed, and Merck. Many of these are just dying assets, unless they do a huge restructuring.

BERNSTEIN If I'm right, as the economic cycle starts rolling over, the other stocks that everybody likes will be devoid of growth, and these will start doing pretty well. If you want a safer way to play tech, try Xerox, a turnaround story.

WILLIAMS Xerox is a good story. I owned it and sold too soon.

BERNSTEIN Xerox has some new products that may gain market share, and they've got more restructuring to come. When everybody thinks a company is going to strike out, you just need a single to do O.K.

WILLIAMS Singles aren't the way to make money. I don't buy unless I see at least 25% upside.

BERNSTEIN In a flat market, it is going to be very hard to find those kinds of situations. So I'm choking up on the bat.

WILLIAMS One company where I could get my 25% is Tyco International. It is still cheap at 12 times earnings and includes some great businesses, such as their fire systems, connector businesses, and U.S. Surgical. If they decide to split it up, it would probably be worth something like 40, and right now it's trading for 28. ■

David B. Scott

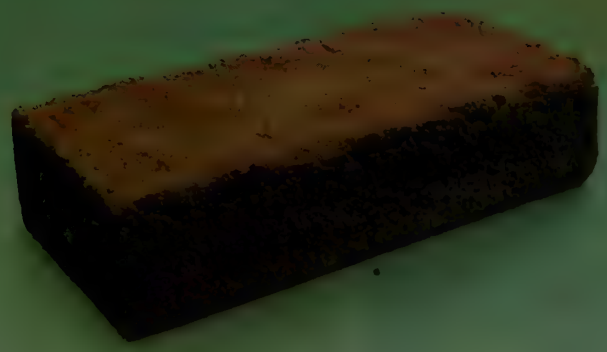
COMPANY/SYMBOL	PRICE*	P&E RATIO**
MOTOROLA MOT	23.41	18
PEPSICO PEP	59.00	20
TEVA PHARMA TEVA	44.48	23
UNITEDHEALTH UNH	63.67	22
XTO ENERGY XTO	44.54	11

David J. Williams

COMPANY/SYMBOL	PRICE*	P&E RATIO**
CELANESE CE	17.10	7
CONSOL ENERGY CNX	63.04	13
ECHOSTAR COMMS. DISH	26.04	13
TJX COS. TJX***	22.91	15
TYCO INTL. TYC	28.37	12

*** Based on year ending January, 2007

skyscraper



Making more possible

ABN·AMRO

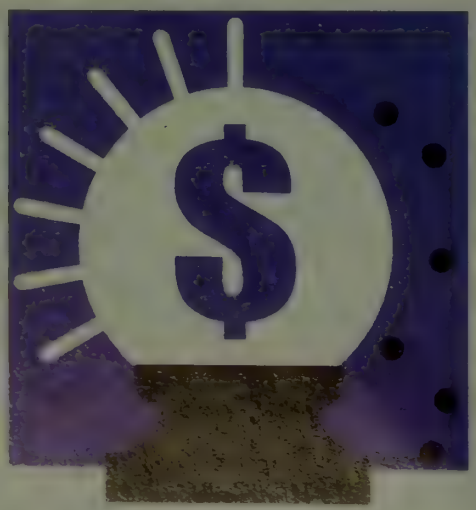
Entering the New Year With a Head of Steam

Expect continued economic strength in 2006, unless the housing or oil markets jump the rails. BY JAMES C. COOPER AND KATHLEEN MADIGAN

In investing, just knowing the right questions to ask can go a long way toward helping you get the most out of your portfolio. That's especially true when your returns are hostage to the uncertain twists of the economy. To help you understand the crucial issues in the investment climate for 2006, *BusinessWeek* addresses six key questions on the economic outlook.

We have plenty of help from our panel of 54 forecasters in our annual outlook survey (table, page 74). On average, they expect the economy to grow 3.3% from the end of 2005 to the end of 2006. That's a shade slower than the expected 3.7% pace for 2005, with growth progressively cooling in each quarter. Profit growth will slow to a pace of 7.3%, and inflation will fall as oil prices slip below $55 per barrel. The Federal Reserve will lift its target rate to 4.75% by spring, from 4% now, and the yield on a 10-year Treasury note will drift up to 5%, from about 4.5%. The jobless rate should edge down to 4.9%, from 5%.

On balance, not a bad scenario, assuming all of this comes to pass. Now the urgent questions that both investors and economists are wrestling with:



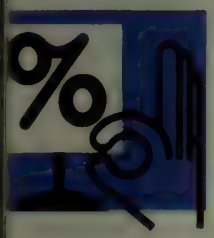
1 Is the economy more likely to be stronger or weaker than the survey consensus?

THE BETTER BET IS ON THE STRONG side. A slight majority (55%) of the forecasters expect the economy to grow more than the 3.3% average projection. While consumer spending and housing will weaken, strength in capital spending, inventory rebuilding, post-Katrina government outlays, and exports will take up the slack. "Fueling growth will be businesses flush with cash and pristine balance sheets putting their [money] to work investing and hiring," says Mark Zandi at Moody's Economy.com.

Many of the pessimists expect this general trend, too. But they also anticipate a sizable hit to consumer spending from the predicted housing slowdown. One problem with that scenario, though, is that few forecasters expect the yield on 10-year Treasuries to rise much above 5%, a level translating to 30-year mortgage rates of about 6.5%. Such rates may slow housing activity, but they will not precipitate a collapse.

Moreover, stronger growth overseas will be a plus. "Export growth should be solid in the coming year as major economies abroad retain forward momentum," says Keith Hembre at First American Funds. That trend, along with slower import growth, should stabilize or perhaps narrow the trade deficit.

2 How high will the Fed have to push interest rates in order to contain inflation?



NO OTHER QUESTION is more important to broad investment decisions than this one. The answer will depend on the strength of the economy and how that affects wages and inflation expectations. The fact that 38% of the forecasters expect the federal funds rate to hit 5% or more suggests a concern that the Fed may tighten more than the consensus expects.

Watch core inflation, which excludes energy and food. Energy prices only have to stabilize at current levels for overall inflation to decline next year. However, most economists expect at least moderate upward pressure on core inflation. If the economy remains as strong as it is now, more companies will pass along current higher costs for energy and labor to their customers. "Pricing power appears to have improved significantly in recent quarters," says John Ryding at Bear Stearns Cos. "Coupled with higher costs, we believe this will lead to higher inflation, which will keep the Fed raising rates through spring 2006."

Don't expect a surge in either core inflation or interest rates. The anti-inflation forces of strong productivity and global competition are still at work. Even a 5% fed funds rate is far from draconian.

3 The housing bubble: Slow leak or pop?

THE VIEW OF MOST economists, including Fed Chairman Alan Greenspan, is that a national home-price bust is highly unlikely. Clearly, many local markets, mainly on the coasts, are overvalued and will face price declines as interest rates rise.

Still, housing presents the Fed with a delicate balancing act. Rising home values and the cash consumers have extracted from their home equity via refinancing and home-equity loans have fueled both consumer spending and the economy. So the less housing slows, the stronger the economy, and the greater the need for the Fed to raise rates. But overtightening policy could severely damage housing, and possibly the overall economy.

Where do rising mortgage rates fit in? They would have to increase far more than expected to hammer housing. In the past, 30-year fixed rates have approached 8% before monthly payments began to disqualify large numbers of potential buyers. But there are new risks now: The rate level could be lower because of higher home prices. Also, JPMorgan Chase & Co. estimates that risky subprime loans make up close to 9% of mortgage debt, large enough to make a downturn worse if these loans begin to fail in large numbers. A high concentration of these loans makes California especially vulnerable.

4 Will the profits boom continue for another year?

THE SHORT ANSWER is no. Profits in 2005 were surprisingly strong, even outside of energy. Through the third quarter, earnings growth for the Standard & Poor's 500 companies beat expectations for the 10th quarter in a row, according to Thomson Financial. "Pricing power is pretty good with profits at a record share of gross domestic product," says David Wyss at Standard & Poor's. In 2006 earnings will grow more slowly but will remain well supported by consumer, business, and foreign demand.

It is normal for earnings to slow as a business upswing gets older, partly because productivity gains diminish and labor costs creep up, squeezing margins. That pattern is likely to play out in 2006. Through the first three quarters of 2005, companies were still boosting their efficiency at a good, if slower, clip. To the extent those efforts continue in 2006—and the imperative from global competition suggests they will—profits should post more modest but still healthy gains.

5 What should investors expect from foreign economies?

GROWTH PROSPECTS abroad have improved. "Eurozone GDP growth will rise from about 1% to 2.5%-3% in 2006, China keeps doing 9%-plus, Japan is back for real, and emerging-market growth remains robust," says James Paulsen at Wells Capital Management.

The two big updrafts will come from the euro zone and Japan, as reflected in the new attitudes of both central banks. The European Central Bank lifted interest rates on Dec. 1 for the first time in five years, and the Bank of Japan is laying the groundwork for ditching its zero-rate policy begun in 2001, now that its long battle with deflation is ending.

Higher interest rates and faster growth abroad will increase the attractiveness of foreign-currency bonds and stocks relative to dollar-based assets. That's one reason economists expect downward pressure on the greenback to resume in 2006. But the U.S. should be able to attract the foreign capital it needs to finance its trade deficit without a dollar crash.

6 What are the wild cards in the outlook that could shake up a portfolio's value?

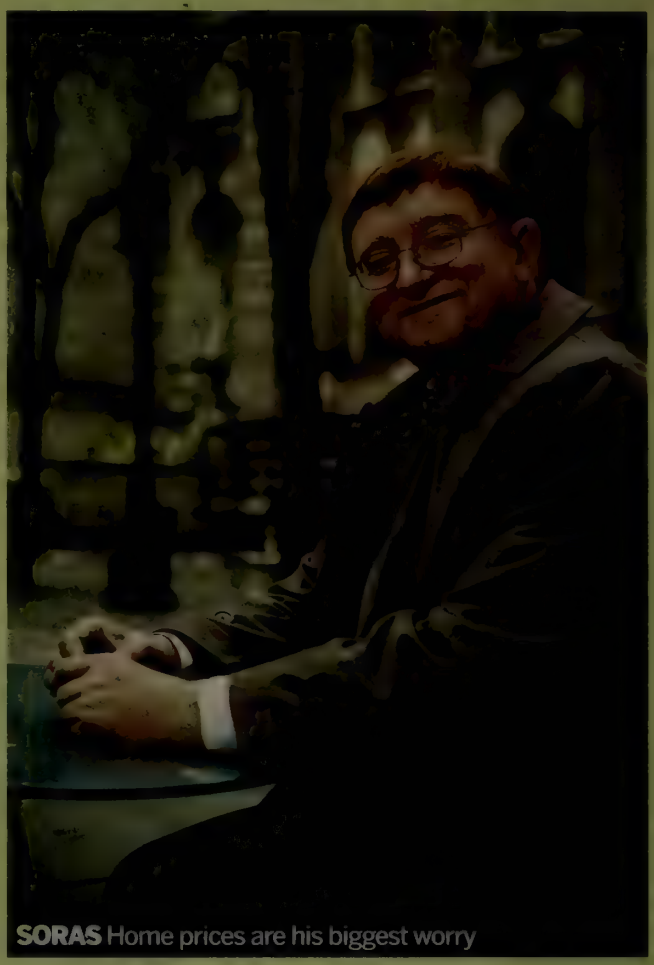
A SHARP DROPoff in housing activity and home prices may not be the expected scenario, but it is at the top of most forecasters' worry lists of what could go wrong in the economy in 2006. So is the price of oil. Its ups and downs could be either a positive or a negative for growth. Any sharp swing out of the range of $45 to $70 per barrel would affect growth and overall inflation.

Fed policy is another prime concern, especially if the economy is stronger than expected, fueling more inflation pressures. Mickey Levy at Bank of America Corp. frets the Fed could overtighten, thereby slowing the economy sharply or creating financial trouble elsewhere in the world. There is also concern about how well soon-to-be Fed chief Ben S. Bernanke will get along with Wall Street. Financial pros think they have a good read on Bernanke, but he lacks the Street savvy of Greenspan. His Fed's behavior in an unexpected financial crisis may be the key test of his rapport with the markets.

Throw in concerns about a possible plunge in the dollar, shrinking foreign capital inflows, and new acts of domestic terrorism, and you have enough in the mix to make any investor queasy. But if the forecasters are right about these six questions, a healthy economy should offer plenty of attractive opportunities to make money. ■

GUESSING RIGHT

A Dogged Dismal Scientist



SORAS Home prices are his biggest worry

Economic growth never follows a straight line, and one of the hardest challenges in forecasting is deciding when the economy will speed up and when it will slow down. Getting the pattern right was the key reason Constantine G. Soras scores as the most accurate forecaster for 2005, according to predictions surveyed by *BusinessWeek* last December. Close on his heels are Michael Carey of Calyon Corporate & Investment Bank and *BusinessWeek*'s Business Outlook team.

Soras, who works for Verizon Communications Corp. and also does economic advising for brokerage firm GunnAllen Financial, based much of his growth outlook on the inventory cycle and auto sales. "I expected good holiday sales in 2004, which means companies would rebuild inventories in the first quarter [of 2005]," Soras says, resulting in a lift to output. Then, he observes, "it seems model yearend sales in autos always cause a spike" in third-quarter economic growth.

As for inflation, Soras missed the mark on oil prices. That was a mistake made by almost all the economists we evaluated. Soras, however, correctly anticipated that inflation would be higher than the consensus estimate. "Clearly, [total] inflation is driven by energy prices," he says, "but I also look at capacity utilization and I wonder, 'can anyone raise prices?' " Given how strong he expected the economy to be in 2005, he felt pricing power would firm up.

So what's on tap for 2006? Soras sees a slight slowdown ahead. First, he doesn't see how auto makers can top the employee-discount deals of last summer. Add in rising interest rates and high oil prices, and he thinks vehicle sales will fall in 2006. Plus, higher mortgage rates and the end of speculative buying in many regions means less demand in housing.

Soras' biggest worry for 2006 is home prices. "To what extent have consumers overextended themselves to buy their homes?" he asks. If homeowners who have adjustable-rate or interest-only loans suddenly face a big jump in their monthly payments, Soras worries that a flood of forced sales could exert steep downward pressure on home prices. Even so, he thinks good labor markets and income growth will enable most consumers to continue spending.

Soras was born in Patras, Greece, and got a bachelor of arts in mathematics at the University of Patras. He came to the U.S. for graduate school, earning both his masters and doctorate degrees in economics from Columbia University. He stayed in the U.S. and married. His wife, Mary, is a vice-president at JPMorgan Chase & Co. They live in Closter, N.J., with their daughter, Christina.

When he's not divining the economy's future, he plays chess on the computer. "I can beat the computer when my mind is clear," he says, "but when I'm not concentrating, boom—I get hit." Obviously, Soras' mind was crystal-clear when he put together his winning 2005 forecast.

–By Kathleen Madigan

The Winning Forecast for 2005

	REAL GDP (% CHANGE, ANNUAL RATE) 1Q	2Q	3Q	4Q*	CPI 3Q	FED FUNDS RATE 3Q	10-YR. TREASURY YIELD 3Q	JOBLESS RATE 3Q
SORAS' FORECAST	3.9	3.5	4.0	3.9	3.1	3.05	5.05	5.3
ACTUAL	3.8	3.3	4.3	3.3	3.8	3.5	4.22	5.0

[illegible] Survey for 2006.

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What the Seers See

BY JAMES MEHRING

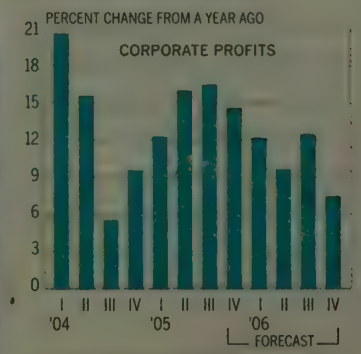
For *BusinessWeek*'s annual economic outlook survey, we asked 54 forecasters for their projections on important indicators that will shape the economy's performance in 2006. We also asked them for their opinions on some of the key trends to watch in the coming year (page 70). We'll take a look at how accurate they are this time next year.

The survey is organized from top to bottom, ranked by the economists' projections for fourth-quarter-to-fourth-quarter growth in real gross domestic product: strongest growth at the top, weakest at the bottom. To help you derive some insights from the numbers, we have included five survey highlights of what the experts expect for some specific areas. Match the color of each column of data with its color-coded counterpart at the right.

The *BusinessWeek* Economic Survey for 2006

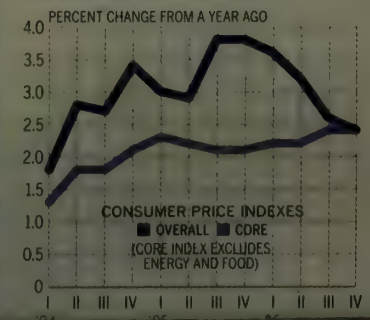
	REAL GDP QUARTERLY PERCENT CHANGE 2006 ANNUAL RATE				YEARLY PERCENT CHANGE 2005 Q4 TO 2006 Q4			2006 Q4 LEVELS (PERCENT)			
	I	II	III	IV	REAL GDP	OPERATING PROFITS*	CPI INFLATION	FEDERAL FUNDS RATE	10-YR. TREASURY YIELDS	JOBLESS RATE	END-2006 CRUDE OIL PRICE
JAMES PAULSEN Wells Capital Management	5.0	4.5	3.5	4.0	4.3	15.0	4.0	5.75	6.00	4.4	48.00
MICHAEL ENGLUND Action Economics	4.3	4.3	3.7	3.6	4.0	8.6	2.3	5.00	5.10	4.7	53.00
JAMES SMITH Econforecaster.com	3.9	3.5	3.5	4.1	4.0	17.2	1.2	5.00	4.51	4.2	31.75
RICHARD BERNER & DAVID GREENLAW Morgan Stanley	3.8	3.4	3.9	4.2	3.9	4.6	2.1	5.00	5.18	5.0	57.20
DAVID KELLY Putnam Investments	4.6	4.1	3.3	3.1	3.9	8.2	1.5	4.50	4.95	4.7	52.00
PETER HOOPER Deutsche Bank	4.4	3.8	3.7	3.3	3.8	5.2	2.2	5.00	5.40	4.9	50.00
JOHN LONSKI Moody's Investors Service	3.5	4.5	3.7	3.6	3.8	7.0	2.7	4.75	5.20	4.6	53.00
JOHN RYDING Bear Stearns	4.1	3.7	3.6	3.8	3.8	8.7	2.5	5.00	5.50	4.7	45.00
MICKEY LEVY Bank of America	4.2	4.1	3.6	3.0	3.7	8.8	2.0	4.75	5.00	4.9	50.00
ED McKELVEY Goldman Sachs	3.5	4.0	3.5	3.5	3.7	4.0	2.4	5.00	4.70	4.5	69.00
DAVID RESLER Nomura Securities International	4.1	4.0	3.2	3.3	3.7	5.7	2.3	4.75	4.58	4.8	52.00
DAVID BERSON Fannie Mae	4.0	3.7	3.4	3.6	3.6	1.6	2.2	5.00	4.90	5.0	45.00
BILL CHENEY John Hancock Financial Services	4.2	3.5	3.3	3.2	3.6	8.0	2.2	4.75	5.00	5.0	50.00
RICHARD DEKASER National City	3.9	3.8	3.4	3.1	3.6	4.5	2.1	4.50	5.10	4.8	49.00
CHRIS VARVARES Macroeconomic Advisers	4.2	3.6	3.4	3.3	3.6	0.9	1.8	4.75	5.10	5.0	57.95
MARK ZANDI Moody's Economy.com	4.0	4.0	3.6	3.0	3.6	5.0	2.8	4.75	5.46	4.9	48.00
WILLIAM DUNKELBERG Natl. Fed. of Independent Business	4.0	3.2	3.3	3.5	3.5	9.0	3.5	4.75	5.60	4.9	49.00
[illegible]	3.8	3.5	3.3	3.2	3.5	[illegible]	1.9	4.50	5.10	4.9	58.00

PROFIT GROWTH SHIFTS INTO A LOWER GEAR



Data: Bureau of Economic Analysis, *BusinessWeek*

A BIT OF PRICE PRESSURE OUTSIDE OF ENERGY



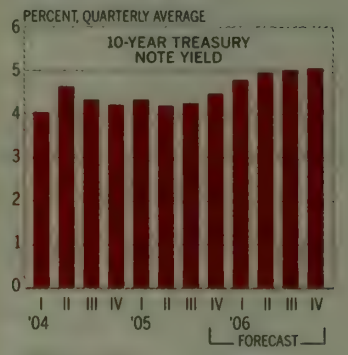
Concerns of increased pricing power will keep the Fed "on

WILLIAM DUNKELBERG NAM Fed of Independent Business	4.0	3.2	3.3	3.5	3.5	9.0	3.5	4.75	5.60	4.3	49.00
DAVID SEIDERS National Association of Home Builders	3.8	3.5	3.3	3.2	3.5	5.5	1.9	4.50	5.10	4.9	58.00
JAMES COOPER & KATHLEEN MADIGAN *BusinessWeek*	4.0	3.5	3.0	3.0	3.4	6.0	2.8	5.00	5.00	4.5	45.00
GENE HUANG FedEx	4.7	3.1	2.9	2.9	3.4	9.0	3.2	4.75	5.65	4.8	54.00
BRUCE KASMAN JPMorgan Chase	3.5	4.0	3.0	3.0	3.4	5.2	1.8	5.00	5.40	4.7	53.00
ROBERT McGEE US Trust	3.8	3.2	3.2	3.3	3.4	7.4	1.9	4.45	4.00	4.7	65.00
JOHN POPE Investment Economics	3.6	3.5	3.3	3.2	3.4	12.0	4.5	4.50	4.50	5.1	62.00
DIANE SWONK Mesirow Financial	3.5	3.5	3.1	3.4	3.4	14.0	2.3	4.80	5.20	5.1	56.00
NARIMAN BEHRAVESH Global Insight	3.9	3.4	3.1	2.9	3.3	3.3	1.6	4.75	5.30	4.8	52.00
KATHLEEN CAMILLI Camilli Economics	3.5	3.2	3.3	3.4	3.3	10.0	3.0	4.25	4.50	4.7	55.00
MICHAEL CAREY Calyon Corporate & Investment Bank	4.0	3.4	2.9	3.1	3.3	1.0	2.6	5.00	5.30	4.9	55.00
DANIEL LAUFENBERG Ameriprise Financial	3.0	2.4	3.7	3.8	3.3	8.3	2.4	4.50	4.90	4.9	57.00
STEVEN RICCHIUTO ABN AMRO	3.9	3.4	3.1	2.9	3.3	3.3	1.6	5.00	4.80	4.8	50.00
STUART HOFFMAN PNC Financial Services Group	3.6	3.3	3.0	2.8	3.2	6.5	2.4	4.55	4.65	4.9	55.00
NICHOLAS PERNA Perna Associates	3.3	3.2	2.9	3.3	3.2	8.5	2.7	4.50	5.47	4.9	65.00
JOSHUA SHAPIRO Maria Fiorini Ramirez	3.6	3.1	3.1	3.1	3.2	6.0	2.6	5.00	5.50	4.8	60.00
GARY THAYER A.G. Edwards	3.0	3.2	3.0	3.5	3.2	8.5	2.8	4.50	4.70	4.9	60.00
DAVID WYSS Standard & Poor's	3.6	3.3	3.0	3.0	3.2	3.4	1.5	4.50	5.50	4.9	49.00
VINCENT BOBERSKI RBC Capital Markets	4.3	2.8	2.4	2.2	3.0	NA	3.0	4.25	5.70	5.5	54.00
TOM HIGGINS Payden & Rygel	2.9	3.0	2.7	2.5	3.0	6.0	2.7	4.25	4.25	4.9	40.00
KURT KARL & ARUN RAHA Swiss Re	2.7	2.7	3.1	2.9	3.0	8.3	2.2	5.00	5.30	4.6	67.00
JAMES MEIL Eaton	4.0	2.7	2.6	2.4	3.0	7.9	3.2	4.75	4.50	4.8	53.00
JOEL NAROFF Naroff Economic Advisors	2.8	3.0	3.5	3.1	3.0	6.4	2.4	4.75	5.50	4.5	47.50
CONSTANTINE SORAS GunnAllen Financial	3.6	3.4	2.3	2.6	3.0	9.7	2.0	4.34	4.76	4.9	55.00
RICHARD YAMARONE Argus Research	3.4	3.1	2.8	2.8	3.0	12.5	3.0	4.75	5.20	5.5	55.00
GAIL FOSLER The Conference Board	2.2	3.7	3.1	2.8	2.9	5.4	3.0	4.25	4.69	5.2	55.00
MAURY HARRIS UBS	3.6	2.8	2.5	2.5	2.9	3.8	2.5	4.50	4.40	4.8	65.00
KEITH HEMBRE First American Funds	3.2	3.0	2.8	2.5	2.9	6.0	1.8	4.25	4.50	5.0	50.00
KEN MAYLAND ClearView Economics	3.3	2.6	2.1	3.6	2.9	9.9	2.8	4.96	5.05	4.7	62.00
MICHAEL NIEMIRA International Council of Shopping Centers	3.0	2.5	2.3	2.5	2.9	3.0	3.3	4.75	5.50	5.5	55.00
ETHAN HARRIS Lehman Brothers	3.5	3.0	2.5	2.5	2.8	2.5	2.2	5.00	4.90	5.0	60.20
LYNN MICHAELIS Weyerhaeuser	3.4	3.7	2.2	2.1	2.8	9.0	3.0	5.40	5.30	5.0	60.00
KEVIN LOGAN Dresdner Kleinwort Wasserstein	3.1	2.6	2.5	2.7	2.7	8.8	1.8	4.16	3.93	5.3	52.00
IAN SHEPHERDSON High Frequency Economics	4.0	3.5	2.0	1.0	2.5	8.0	1.9	4.70	4.80	4.5	50.00
DAVID ROSENBERG Merrill Lynch	2.2	2.0	2.5	3.0	2.4	NA	1.3	3.50	4.00	5.5	57.00
CONSENSUS	3.7%	3.4%	3.1%	3.1%	3.3%	7.0%	2.4%	4.73%	5.02%	4.9%	53.83

* Before-Tax Corporate Profits with IVA and CCA (NIPA BASIS)

Concerns of increased pricing power, will keep the Fed "on guard all year long," says Richard DeKaser at National City Corp. However, potential price pressures are expected to be offset by solid productivity gains and a gradual easing in economic growth. As a result, a majority of economists, 37 out of 47, expect the Fed to wrap up its tightening cycle by mid-year, with a consensus expecting interest rates to top out at 4.75%.

NO, REALLY, LONG-TERM RATES WILL RISE



Data: *BusinessWeek*

A STEADY LABOR MARKET, WITH RISKS

The unemployment rate is expected to be 4.9% by the end of 2006, virtually unchanged from the current 5% level. Perhaps the biggest risk for the job market and the economy overall is housing. The end of the housing boom could depress consumer demand, causing companies to reduce hiring plans. "Construction employment alone has accounted for 16% of total job gains since 2001," notes Keith Hembre of First American Funds.

CHARTS BY LAUREL DAUNIS-ALLEN/BW

[WHERE TO INVEST]

The Best Plays

More risk, more reward: Investments pegged to hot sectors

TECHNOLOGY >> P. 78
Madison Ave and New Media: Online companies are luring eyeballs and ads

BIOTECH >> P. 80
These companies could bring enormous payoffs—for those willing to take a risk

ENERGY >> P. 82
Robust worldwide demand for oil and gas should keep the industry's profits pumped

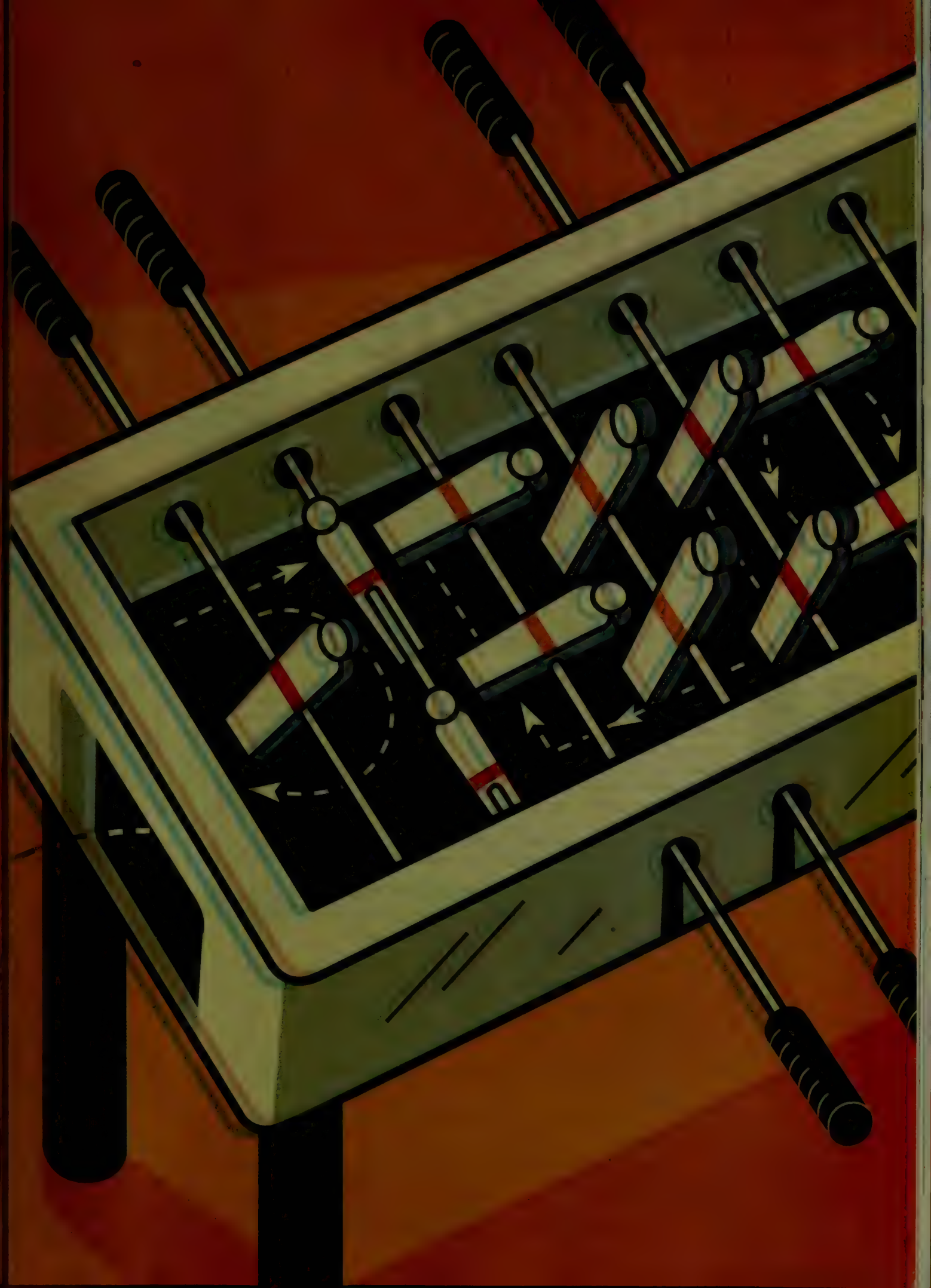
PUBLIC WORKS >> P. 84
America's aging infrastructure could be a boon for plenty of companies

BABY BOOMERS >> P. 86
Businesses that cater to older Americans face a healthy future

A BETTER WAY TO GO ABROAD >> P. 90
Why so many savvy global investors are flocking to exchange-traded funds

EMERGING MARKETS >> P. 94
Beyond the Big Four: Egypt, Mexico, and Poland boast strong growth, too

HARRY CAMPBELL



Online: Where the Growth Is

New Media are luring eyeballs and ads—and the market is betting big on Google and Yahoo! BY TIMOTHY J. MULLANEY

MORE THAN 220 years ago, when the British surrendered to the colonials at Yorktown, Va., legend says Lord Cornwallis marched out to a tune called *The World Turned Upside Down*. Today, a media investor knows just how the defeated commander must have felt. Media's collisions and revolutions are upending our notions about which companies and technologies matter in the $1.3 trillion industry. Downloads are transforming the music business, and pay-per-view is looming for movies and cable TV, while advertising is sprinting to the Internet. The media pie is growing faster than the economy, about 7% a year, according to PricewaterhouseCoopers' most recent forecast. But what we spend the money on, and who gets it, is changing enormously. And that means the media world will see plenty of winners and losers.

The market is betting hard on Internet companies such as Google and Yahoo! at the expense of big conglomerates because New Media are where all the growth is. Consulting firm Parks Associates forecasts that the Net will double its share of the U.S. advertising market, to 10%, by 2010. And that's a conservative estimate. It assumes Web advertising, now a $12 billion market, grows just 14% a year, about half the current pace. More aggressively, Piper Jaffray analyst Safa Rashtchy, one of the first to spot the potential of advertising tied to Internet search results, says the growth will be more like 20% a year in the U.S. and 40% abroad. If he's right, the global Web advertising market will hit $55 billion by 2010, up from $19 billion now.

The big losers are likely to be cable companies and others that distribute programs over expensive pipes. Pricing in that business is becoming cutthroat as phone companies such as Verizon Communications and SBC Communications follow satellite-TV outfits such as DirecTV into competing with cable. Legg Mason Value Trust manager William H. Miller III says he acted on this trend in 2004 by selling shares of Comcast and using the money to add to his Yahoo holdings. "Value is migrating to new media," Miller says. "We think content is getting more valuable and

Winners from Convergence

COMPANY/SYMBOL	PRICE*	P-E**
APPLE COMPUTER AAPL	76.33	34
Expensive, but still the innovator in online music and now video		
aQUANTIVE AQNT	27.15	45
The biggest Web ad agency and a leading player in advertising on emerging media		
R.H. DONNELLEY RHD	63.22	16
Yellow Pages publisher could make key alliances with portals or get bought		
GOOGLE GOOG	409.20	48
Expensive, but central to changes in huge markets such as local advertising		
NETFLIX NFLX	25.74	31
Will be a juicy takeover target if it can't make the transition to video-on-demand		
WALT DISNEY DIS	25.19	16
Its ESPN unit is preeminent in the high-growth sports market		

*Dec. 9 **Based on 2006 earnings estimates. **Data:** Bloomberg Financial Markets, I/B/E/S

distribution is getting less valuable."

If you want to bet on the New Media age, the first place to look is Google. Granted, the search engine was an easier pick eight months ago, when it traded around $200. Google now trades at 48 times the earnings Wall Street analysts expect for 2006. Is that too much? Maybe, but not if you think influential Citigroup Smith Barney analyst Mark Mahaney is right. On Dec. 9 he sharply increased his estimates by nearly 60¢ a share. Now he says Google will earn $8.84 a share in 2006, in part because it gained 10 points of market share in 2005. That puts Google's price-earnings ratio at 48. "We are removing what was an overly conservative bias in our estimates," Mahaney says.

SLOW BUT SURE

FOR A BROADER PLAY on Web advertising, try Seattle ad agency aQuantive. Its Avenue A/Razorfish unit is the largest agency buyer of ads tied to Web search. And aQuantive is a leader in pay-for-performance schemes that tie payments for online ads to the sales they actually generate. It is also in the forefront of bringing ways to measure and personalize ads to traditional media such as print and TV. aQuantive is a little expensive, trading at 45 times 2006 earnings estimates. But Merriman, Curhan & Ford analyst Richard Fetyko forecasts its profits will grow at 25% a year.

> Walt Disney is an Old Media outfit making a forceful transition to the New Media world

It seems counterintuitive to bet on change coming more slowly than expected, but it makes sense because some transformations take longer than others. Consider Netflix. The online video-rental company spent the past year fighting off an expensive challenge from rival Blockbuster, but good times are starting to roll again. Analysts say Netflix will make 82¢ a share next year, putting its p-e ratio at a reasonable 31.

The threat to Netflix is that video-on-demand could kill the market for DVD rentals. But CEO Reed Hastings says VOD is materializing more slowly than expected because of wrangles over getting studios to license more movies for digital downloads. That makes next year's profits more secure—and gives Netflix time to get big before VOD does. Someday a phone, cable, or Web media company will want to deliver movies online. And the 20 million subscribers Hastings believes Netflix will reach between 2010 and 2012 (it has 3.6 million now)—all in the habit of paying for movie subscriptions—will come in handy. Netflix could be an acquisition candidate for a company that wants to distribute movies online or stay independent and win attractive terms as a partner.

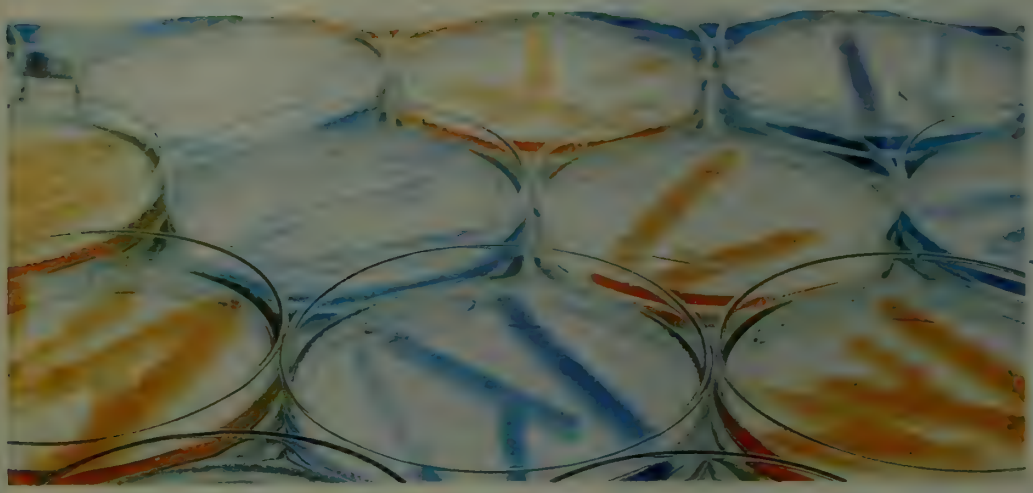
Even New Media devotees can hedge their risks with some judicious bets on Old Media companies that are making a decent transition to the new world. One of them is Walt Disney, whose ESPN.com sports site is much larger than anything Viacom and Rupert Murdoch's News Corp. have at present. It's a leader in rich-media advertising, which offers video or animation that spiffs up brand advertising. Plus, sports-related businesses are expected to grow faster than most traditional media, according to PricewaterhouseCoopers. Another reason to like Disney: It partnered early with Apple Computer—still the most innovative player in digital downloads—to offer ABC programs via its iTunes site.

GOLDEN PAGES

BELIEVE IT OR NOT, among the hottest media bets is the $15 billion-a-year U.S. Yellow Pages market. Analysts at Kelsey Group forecast that $5 billion of locally targeted, small-business advertising will move online by 2009. But Yellow Pages companies have two things Web companies like: Internet-like margins of 40% or more and armies of local sales reps—which portals don't have—to sell advertising to small companies that lack tech savvy.

That makes companies such as R.H. Donnelley, which publishes directories in 18 states, hot properties. Already, private equity types are sniffing around Verizon's Yellow Pages business, which is for sale. AT&T is taking its Yellow Pages business national through YellowPages.com. Even Barry Diller's IAC/InterActiveCorp, which has an elaborate local-advertising strategy and a cash-flow-conscious acquisition strategy, isn't out of the question. Since Donnelley is one of the few pure Yellow Pages plays, it's a good way to wager on the industry's strong cash flow and consolidation.

The media world can be baffling not just because of its size but also because of the number and speed of changes. But investors who bet on companies that have great content and Web advertising—and are selling at reasonable multiples—should do all right. ■



Biotech Bets

For risk-takers, these companies could bring big payoffs. BY ARLENE WEINTRAUB

JUST SIX MONTHS ago gloomy biotech executives used terms such as "nuclear winter" at an industry conference to describe how poorly their stocks were performing. But soon after, major players such as Genentech Inc. and Amgen Inc. began reporting good news, ranging from strong sales of current products to promising data on experimental drugs. Their fortunes boosted the entire sector: The Amex Biotechnology Index soared 20.1% from July 1 through early December. In that same period the Standard & Poor's 500 Health Care Index crept up just 1%.

Despite the bounce, the sector's leading analysts say bargains are out there for those willing to take on a lot of risk. Most biotech companies are still racking up losses as they struggle to get their first products approved by the Food & Drug Administration. Without profits, it's impossible to judge a stock on such tried-and-true measures as price-earnings ratio. Even a hint of bad news can send a company's shares tumbling.

To vet the sector, start with the biotechs that are profitable. Analysts are especially high on giant Amgen. Despite a 27.3% runup in the stock since July, it trades at about 77, or 21 times its expected 2006 earnings. The Thousand Oaks (Calif.) company is ringing up double-digit sales growth on its drugs to treat anemia and rheumatoid arthritis, and its pipeline includes potential blockbusters for cancer and osteoporosis. Yet the ratio of p-e to its estimated long-term growth rate (PEG) is 1.51—a steal compared with Genentech, which is trading at a PEG of 2.27. Another biotech large cap, Genzyme Corp., is slightly more pricey than Amgen but could pay off for long-term investors. Analysts expect the Cambridge (Mass.) company to continue to bolster its lead in treating enzyme disorders.

When it comes to finding values among smaller biotechs, one strategy is to look for companies whose share prices seem out of whack with their revenue prospects. Tercica Inc., for example, is about to launch its first drug, which treats a form of short stature in children. A Dec. 12 approval of Insmed Inc.'s competing drug sent Tercica's shares down 29%. Still, analysts estimate Tercica's sales could peak at $200 million. Even though the Brisbane (Calif.) company has nothing in the near-term pipeline, "a one-product company is less risky than a no-product company," says Eric Schmidt, an analyst for SG Cowen & Co. With the stock trading at about 7, Tercica's market capitalization is just $222 million, or 1.1 times expected sales. Most biotech stocks trade at four times sales or more, and Tercica's could catch up.

SLEEPER STOCKS

ANALYSTS ALSO ARE enthusiastic about biotechs that are developing drugs for under-treated diseases. Threshold Pharmaceuticals Inc. of Redwood City, Calif., is working on a treatment for pancreatic cancer and a drug to treat enlarged prostate—which affects nearly all men over 60. Yet it's trading 17% below analysts' mean price target.

Among the biotechs that recently made their debut on the Street, a handful may be below-the-radar winners. Many biotech initial public offerings have flamed out of late, causing other new—but more worthy entrants—to fall, too. One example is Inhibitex Inc., an Alpharetta (Ga.) company that went public in 2004 and is in the late stages of developing a drug to treat infections in premature infants. Christopher Raymond, an analyst for Robert W. Baird & Co., estimates that if the drug hits the market in 2007, it could pull in $150 million in sales a year by 2010. That makes the stock, which trades at 8.13, worth 15, he says.

While biotech's dreary days are past, the potential for bad news from any one company always looms large. Still, for an investor with a penchant for risk, the sector offers rich returns. ■

Bargain Hunting

COMPANY/SYMBOL	PRICE*
AMGEN AMGN Lively sales of its flagship drugs, plus a strong pipeline, portend years of double-digit growth	77.46
GENZYME GENZ This biotech big cap rules its niche: Making drugs to treat genetic enzyme deficiencies	72.48
INHIBITEX INHX A potential blockbuster drug to treat infections in preemies could win FDA approval in 2007	8.13
TERCICA TRCA Its new, first-in-class drug to treat short stature could hit $200 million in sales	7.02
THRESHOLD PHARMACEUTICALS THLD Pivotal data on a promising remedy for pancreatic cancer is expected in 2006	13.80

*Dec. 13, 2005
Data: BusinessWeek, Bloomberg Financial Markets

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Lots of Oomph In Oil and Gas

Robust energy demand worldwide should keep profits pumped. BY MARK MORRISON

AFTER TWO YEARS OF strong gains, are energy stocks running out of gas? Not at all, says Standard & Poor's oil analyst Tina J. Vital. "The year ahead could be a repeat of 2005," when they rose 34%, she says. New investors "won't be late to the party," agrees Evan Smith, co-manager of the $780 million U.S. Global Investors' Global Resources Fund.

Why the optimism, when the chief executives of BP PLC and Shell Oil are fretting that oil and gas prices are inflated and bound to fall? Simply because with supplies remaining tight in the face of growing demand around the world, profits are again expected to rise sharply. In fact, Smith expects a much longer and stronger up-cycle than usual because so many oil and gas producers underinvested in their business for the past two decades and have years of catching up to do to develop new supplies.

All the same, expect a wild ride on the way to higher valuations. Energy stocks tend to overreact to short-term fluctuations in prices of oil and gas, which zig and zag according to weather reports, global politics, and economic shocks.

With that in mind, major integrated oil companies may be the safest plays. Most have single-digit price-earnings ratios and rock-solid balance sheets, and they pay nice dividends. S&P's Vital points to Chevron Corp., which she expects to make its numbers more reliably as it further digests the August Unocal Corp. acquisition. It announced a $5 billion stock buyback on Dec. 8. She also likes Exxon Mobil Corp., which has virtually no debt and rewards investors with ever-fatter dividends. Money manager Smith prefers Petro-Canada and Brazil's Petrobrás. Both are aggressively adding to their reserves while rivals are struggling just to replace what they produce each year.

One smart bet, some experts suggest, would be companies heavily tilted toward natural gas. A.G. Edwards & Sons Inc. analyst Thomas E. Covington likes mid-size players such as XTO Energy Inc. and EOG Resources Inc. They are positioned to make more than two-thirds of their revenues from natural gas and add to them faster than rivals even if gas prices moderate.

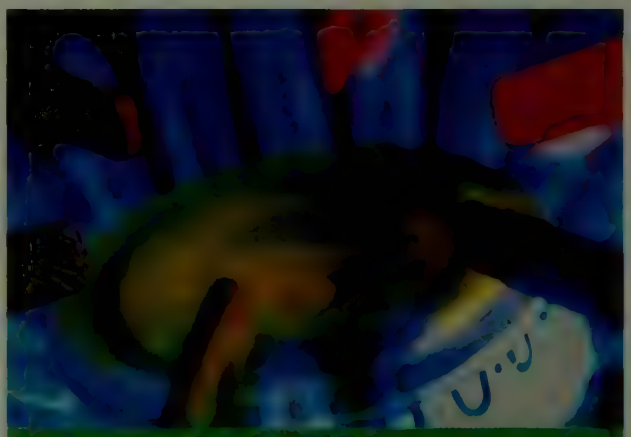
Other parts of the oil patch may offer even more upside—with a lot more risk: companies that drill wells and supply equipment or services, for instance. They are racing to keep up with their customers, the major and independent exploration and production outfits, which are poised to boost capital spending by double-digit percentages, after hefty increases in 2005. Kurt Hallead, an analyst at RBC Capital Markets, recommends service companies Baker Hughes and Smith International as well as drillers Rowan and GlobalSantaFe—expecting all of them to beat current Street earnings estimates by 5% to 10% in 2006.

REJUVENATED

GLOBAL RESOURCES' Smith likes TODCO, which has recently put back to work seven drilling rigs that had been mothballed for several years. The Houston-based contract driller, which specializes in shallow-water rigs concentrated in the Gulf of Mexico, is a good example of the industry's rejuvenated earning power. Its profits jumped to $38 million as revenues climbed 35%, to $383 million, in the first nine months of 2005, up from a $32 million loss a year earlier.

TODCO's former parent, Transocean Inc., is another good pick. Some of its deepwater rigs are fetching $400,000 per day, double the rate of two years ago. And it is locking in long-term leases. Some analysts estimate earnings could almost triple in 2006. Still, Transocean stock sells at a rich 45 times trailing earnings after jumping 80% in the past 12 months, so investors should try to buy it on weakness.

Investors should also keep in mind that even if the next couple of years are robust, energy is a cyclical industry. Companies are investing billions in new projects that may not pay off for five or even 10 years. That calls for resilience, patience, and some diversification among the different types of energy players. ■



Power Up Your Portfolio

COMPANY/SYMBOL	PRICE*	P-E RATIO**
BAKER HUGHES BHI	61.97	19
Its broad range of equipment and services is benefiting from global growth in drilling		
CHEVRON CVX	62.28	8
Sells at a discount to other majors, but earnings disappointments may be behind it		
PETROBRAS PBR	71.13	6
Brazilian company could outperform as it adds petroleum reserves		
SCHLUMBERGER SLB	99.83	23
Expensive, but its technology is increasingly valuable to exploit new and old fields		
TRANSOCEAN RIG	68.66	15
Biggest of the deepwater drillers is expected to score huge earnings gains		

*Dec. 9 **Based on 2006 earnings estimates Data: Bloomberg Financial Markets

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A Pipeline To Profits

America's aging infrastructure could be a boon for plenty of companies. BY DEAN FOUST

FOR MANY COMMUTERS, the daily traffic snarls, potholes, and bridges under repair serve as a constant reminder of the deterioration of the nation's infrastructure, much of which hasn't been updated in decades. Cash-strapped state and local governments have long deferred as much spending on roads, bridges, and water and sewer systems as possible.

The bill is coming due. According to a November study by consultants Cambridge Systematics Inc., governments will need to cough up an additional $500 billion for construction and repair of roads and bridges over the next decade just to maintain the status quo. Modernizing the nation's aging water and sewer systems, meanwhile, could cost as much as $660 billion over the next 20 years, according to the U.S. Environmental Protection Agency. At $33 billion a year, that would be a sharp increase from the roughly $10 billion that state and local governments currently spend.

Daunting though the task may be, overhauling the nation's infrastructure should create opportunity for savvy investors. Alas, finding bargains among engineering, construction, and service companies isn't as easy as it was a year ago. But infrastructure is a 10-to-20-year growth story, so there are still plenty of chances for long-term investors. Brett Gallagher, head of U.S. equities at Julius Baer Investment Management Inc., recommends the Macquarie Infrastructure Company Trust, a holding company created by one of Australia's largest banks. The trust owns everything from toll roads to airport parking lots in the U.S. and abroad and provides heating and air con-

litioning to such corporate customers as he Aladdin Resort & Casino in Las Vegas. Gallagher is attracted to the Macquarie rust's hefty 6.5% yield. "That's certainly etter than any bond you're going to ind—and the yield is growing," he says. The Macquarie trust generated cash flow f 58¢ per share in the quarter ended ept. 30, providing ample coverage of the 0¢ quarterly dividend. And with 85¢ a hare in cash on hand following the acquisition of another airport parking facility in early October, it's possible that Macquarie will raise the payout in coming years.

In construction, big is good. Richard Rossi, an analyst for Morgan Joseph & Co., a New York brokerage, says one of he best infrastructure plays is Michael Baker Corp., a Moon Township (Pa.) engineering outfit that has experience tacking complex construction projects—everything from the Trans-Alaska Pipeline System to the New River Gorge Bridge in West Virginia. "They have the rainpower to do large, complicated jobs, nd once you get to large projects, the umber of competitors drops off dramatically," says Rossi. He notes that Baker's acklog has already grown to $1.4 billion, r roughly double the level at the end of 003. At just over 22 a share, Baker trades t a multiple that's just below its 15% rowth rate.

WATER WORLD

THE TRULY GLISTENING infrastructure plays might be in water, says Daniel Boone, portfolio manager for he Calvert Social Investment Fund. He ites the number of conglomerates that ave been bolstering their exposure to vater-related businesses. "When you ee savvy companies like General Electric buying into this business, you know they're on to something," he says. One of Boone's favorite water plays is Pentair Inc., a Golden Valley (Minn.) industrial company that now derives 80% of its revenues from water-related systems. These range from water pumps used to clear floodwater out of New Orleans, to filtration and purification systems used by everyone from municipal water providers to Starbucks Corp., which wants to ensure that its lattes and frappuccinos taste the same around the country. Boone says Pentair is usually pricey, but that a pullback in the stock since July from 45 to 37 provides a buying opportunity.

> Upgrading just the water and sewer systems could cost $660 billion over the next 20 years

Another company that seems flush: Insituform Technologies Inc., a Chesterfield (Mo.) company that makes equipment for rehabilitating municipal sewers and water mains. John Quealy, an analyst with Adams Harkness & Hill Inc., a Boston brokerage, says that as municipalities face up to the expensive task of repairing their aging sewer systems—an endeavor that will cost the city of Atlanta as much as $3 billion over the next 12 years—they'll flock to Insituform's cost-efficient services. Among them: a proprietary system for relining, rather than replacing, existing pipes using flexible, jointless tubes made out of resin and other materials. "It's like a catheter or stent for a sewer pipe. It becomes a pipe-within-a-pipe," says Quealy.

Boone, the Calvert fund manager, also likes FMC Technologies Inc., a Houston company that makes equipment for oil and gas drillers. Boone notes that despite the heavy damage suffered by the oil and gas rigs off the Gulf of Mexico from this year's hurricanes, there was no environmental damage. Many of the rigs were fortified with FMC's "subsea trees"—essentially, pipes that connect a drilling platform on the surface to the well below. Drillers swear by the pipes because they have the ability to separate oil and natural gas from water and sand down at the sea floor—sending only fuel to the surface—and because the pipes are rugged enough to withstand pressure of 15,000 pounds per square inch from storms. "We didn't have any spills from Katrina that contaminated the water," notes Boone. He says oil and gas exploration in the Gulf should increase in coming years—and that augurs well for FMC. Analysts expect the company to increase its earnings by close to 20% annually over the next five years.

EASY METER READING

THE ELECTRICITY CRUNCH in 2003 revealed the degree to which the nation's power grid is overtaxed. Analysts say some of the most interesting plays are companies that help utilities stretch capacity. Quealy recommends Itron Inc., a Spokane (Wash.) maker of next-generation electrical meters. Itron helps utilities save money by automating the process of meter reading. Instead of going house to house, meter readers can drive down the street and take readings from the truck. Itron also sells devices that, once installed in homes, allow consumers to see a minute-by-minute cost estimate of how much energy they're consuming—and other devices that, with the consumer's consent, allow the utility to trim back power to certain houses and thus reduce output. "This gives utilities very good flexibility in maximizing their power generation," says Quealy. And given that 70% of all meters must be read manually, Quealy says, there's still a vast replacement cycle ahead. Analysts expect Itron to boost its earnings by an average of 20% in each of the next five years. A power crisis during that span could electrify Itron's profits even more. Infrastructure stocks always look better when things are falling apart. ■

Long-Term Plays

COMPANY/SYMBOL	PRICE*	P-E RATIO**
FMC TECHNOLOGIES FTI Producer of drilling pipes used by oil companies that can withstand hurricanes.	42.92	19
INSITUFORM TECHNOLOGIES INSU Its jointless tubes can be used to repair aging water and sewer pipes cheaply.	20.82	23
ITRON ITRI Sells meters that measure power usage and help utilities minimize brownouts.	47.43	23
MACQUARIE INFRASTRUCTURE MIC Operates toll roads, airport parking lots, and more. Pays a hefty 6.5% yield.	30.66	30
MICHAEL BAKER BKR Engineering company could benefit from need to repair creaky bridges and highways.	22.19	12
PENTAIR PNR Makes pumps and purification systems used by everyone from municipalities to Starbucks.	36.75	17

*Dec. 9 **Based on estimated 2006 earnings

Data: Bloomberg Financial Markets, I/B/E/S

Cashing In on Life Extension

Companies that cater to aging Americans face a healthy future. BY TODDI GUTNER

AS THE FIRST OF THE Baby Boom generation turns 60, money managers expect another kind of boom—in the revenues and earnings of companies that cater to this aging cohort of 77 million Americans. The older boomers, now age 50-plus, are in their peak earning years, and "the demand for products they use is growing faster than average," says Tom Laming, president of TrendStar Advisors. While some of these stocks may seem pricey, keep in mind that "this is just the beginning of an 18-year span of retiring boomers. So these companies have a long path of growth ahead of them," says Leslie Globits, portfolio manager of Victory Special Value Fund.

» ALLERGAN The older you are, the more likely you are to suffer from eye ailments such as cataracts, glaucoma, and dry eye. So an increase in the elderly population bodes well for Allergan Inc., a leading manufacturer of ophthalmologic pharmaceuticals.

What sets Allergan apart from its rivals, such as Alcon Inc. and Bausch & Lomb Inc., is the company's focus on cosmetic therapies. Allergan has a patent on Botox, the preferred boomer alternative to facelifts. Allergan also is expanding its cosmetic surgery business by acquiring Inamed Corp., maker of other facial fillers, breast implants, and the LAP-BAND, a device that blocks off part of the stomach so that it can hold less food. That product is growing rapidly, as it is less invasive than gastric bypass surgery.

» PULTE HOMES The anxious rumors about the real estate bubble and rise in interest rates has brought homebuilding stocks down off their 52-week high. But Pulte Homes Inc.'s Del Webb unit, the largest U.S. builder of "active adult" communities, will help to insulate the company. Some 30% of its sales come from this division, which is rapidly opening communities for residents at least 55 years of age. Del Webb has built 41 so far, in the suburbs of Boston, Chicago, and New York, and plans to move into metro Atlanta, Dallas, and Minneapolis. The best part about catering to the boomer market is that 50% of the buyers pay cash, so they aren't as sensitive to higher mortgage rates.

» SEI INVESTMENTS In the past six months, the first of the boomers have begun to withdraw funds from their retirement accounts without penalties. SEI Investments Co. is betting they'll need lots of financial advice. "The company has completely retooled to meet this need," says Rachel Barnard, senior equity analyst for Morningstar Inc. SEI provides financial programs to independent financial advisers. SEI's return on equity of 45% is well above the 10% of its direct competitor Bisys Group Inc. It also has healthy profit margins of 24% and gross margins of 50%, nearly 10 percentage points above the industry norm.

» STEINER LEISURE With time on their hands and a keen sense of adventure, boomers want to travel the world—in style. Steiner Leisure Ltd., which runs spas on 120 cruise ships, aims to serve that need. Despite beating Wall Street's earnings estimates for the last 13 quarters, Steiner still sells at a reasonable price-earnings ratio of 15. "This $640 million [market cap] stock hasn't appeared on analysts' radar screens yet," says Victory Special Value's Globits.

» ZIMMER HOLDINGS As boomers live longer, more active lives, they'll need to replace some of their body parts to keep going. Zimmer Holdings Inc. is one of three leading manufacturers of orthopedic reconstructive products such as joints, hips, and knees. It's also the purest play on the higher-margin business of orthopedic implants. Though the stock is down more than 25% from its 52-week high, analysts expect earnings per share to average 17% a year over the next five years. ■

Booming on the Boomers

COMPANY/SYMBOL	PRICE*	P-E RATIO**
ALLERGAN AGN	108.79	29
Makes drugs to treat eye diseases of the aging. Owns Botox franchise. Expanding into cosmetic surgery.		
PULTE PHM	40.71	7
Its Del Webb unit is largest U.S. builder of retirement communities. Some 50% of purchasers pay cash.		
SEI INVESTMENTS SEIC	39.42	19
Recently retooled to provide wealth management services for financial planners who serve retiring boomers.		
STEINER LEISURE STNR	35.96	15
Market leader of spa services to 120 of the largest cruise ships and resort hotels.		
ZIMMER HOLDINGS ZMH	68.42	19
Leading maker of orthopedic implants for joints and spines that help keep boomers active.		

*Dec. 9 **Based on 2006 earnings estimates
Data: BusinessWeek, Bloomberg Financial Markets, I/B/E/S

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* October 2005, ten investment banks forecast the average nickel price from 2005 until 2007 at $6.02 per pound

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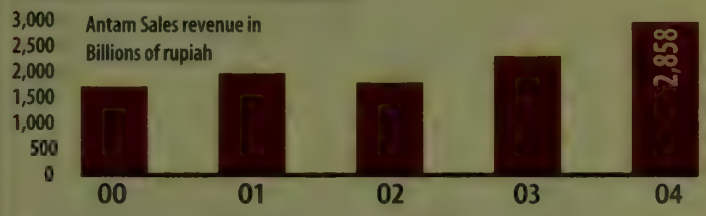
Rp Billion	9M04	9M05	YoY
EBITDA	893	1,134	+27%
Net Income	539	711	32%
Total Debt	2,045	2,067	+1%
(USD million)	225	205	–9%
Debt/Equity	93%	71%	–24%
ROE *	13% (2003)	38% (2004)	+192%

* Full Year 2003 and 2004

GROWING STRATEGICALLY

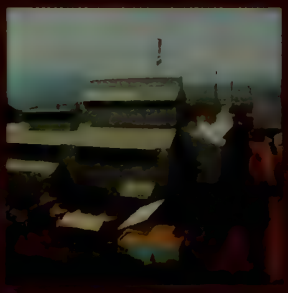


END OF YEAR SHARE PRICE SINCE IPO (Rp)

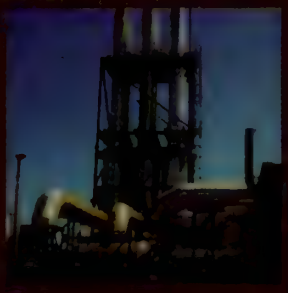
Processing silver at Logam Mulia

Ferronickel ingot ready for export

A nickel pour at Pomalaa



New ferronickel facility



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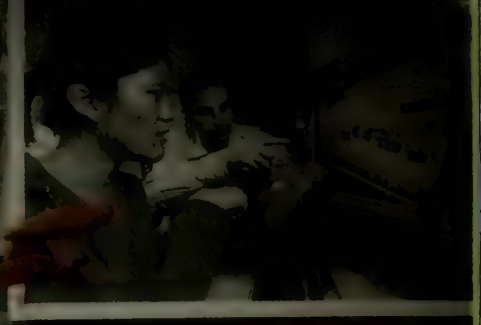
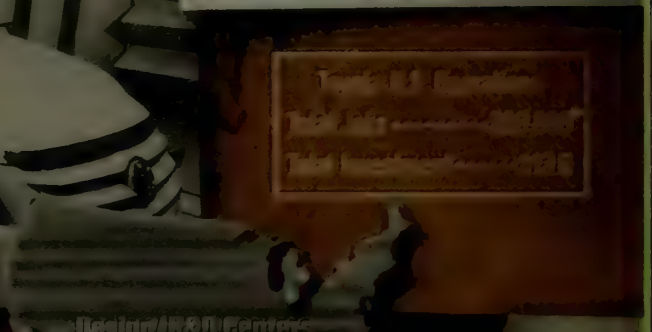
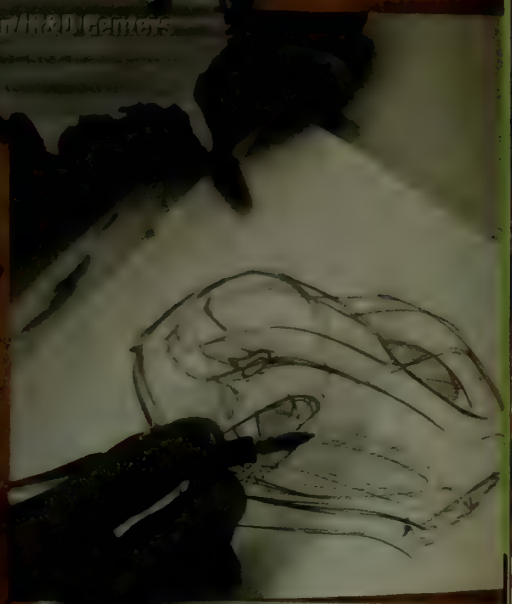


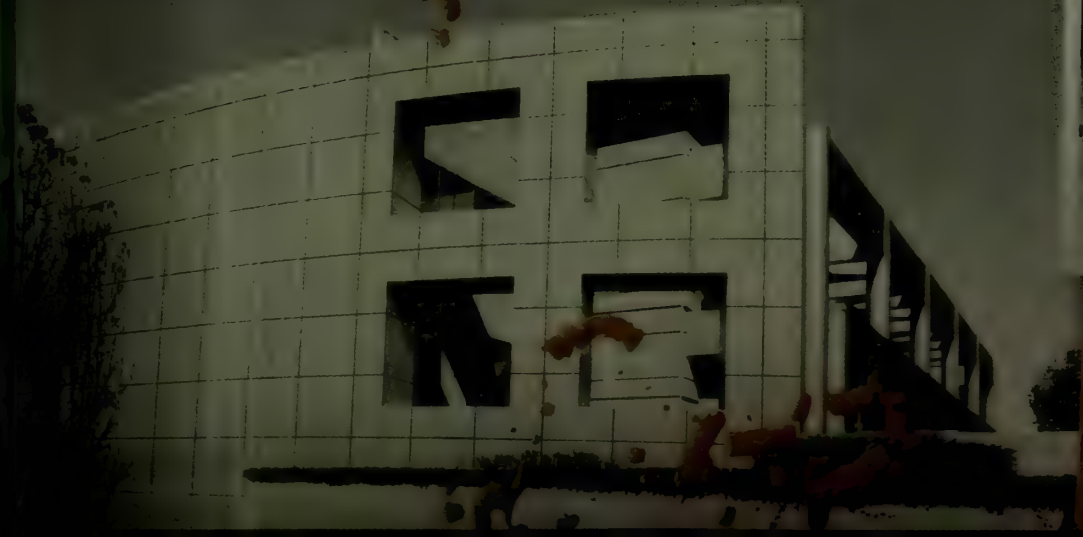


Where we go when we go back to the drawing board.



AUTOMOTIVE DESIGN IS A FIELD FOR DREAMERS. Eventually, the best dreams become real. The project ends, a new one begins, and back to the drawing board the designers go. Our Calty Design Research centers are full of such inspired dreamers. Together with the talented engineers at Toyota Technical Center (TTC), they bring these dreams to life. Yet Calty and TTC may be two of Toyota's best kept secrets.

By now, most people know that we build vehicles in the U.S.** But what they might not know is just how much we rely on Calty and TTC. They're an integral part of our investment in America, and we can't wait to see what they draw up next.



TOYOTA

toyota.com/usa

A Better Way To Go Abroad

Why savvy global investors are flocking to exchange-traded funds. BY AARON PRESSMAN

WITH U.S. STOCKS stuck in low gear for two years now, traders have had little choice but to search the globe for opportunities. Their detective work has paid off: The MSCI Europe, Australasia, & Far East Index jumped 20% in 2005 through Dec. 9, more than six times the Standard & Poor's 500-stock index's 3% gain for the same period.

Analysts expect more of the same in 2006. Despite the recent rally, many foreign markets are still cheaper than the U.S., says Jeffrey D. Saut, managing director of investment strategy at Raymond James & Associates. Investors, he says, ought to have at least 20% of their portfolios overseas, with healthy chunks in fast-growing countries such as Brazil, Malaysia, and Thailand.

Fair enough. But the trick to international investing is finding the right tool for the job. It's difficult for Americans to buy foreign stocks directly. U proxies for foreign stocks, cal American depositary receipts, available only for a small fract of the publicly traded compan around the world because of st listing requirements in the U.S

Mutual funds, meanwhile, rather blunt instruments. Mos them target broad regions; so even try to capture the perfor ance of the entire global equ market. And mutual funds priced just once daily, at the end the day. That could pose proble in foreign markets, where lo blowups spread quickly.

FREEDOM TO FLEE

INCREASINGLY, GLOBALLY o ented investors are flocking to change-traded funds (ETF which are baskets of stocks th typically hew closely to market dexes. In 2005 through Octob (the latest figures available), $ billion flowed into internatio ETFs, up 60% from the same pe od last year. The appeal? ETFs bought and sold on exchanges current prices throughout the d most have low expense ratios, a some target specific countri such as Japan, China, even B gium. The downside: Investors cur transaction costs for every trade th make. But if a storm erupts, brokera fees are a small price to pay for the fr dom to flee.

Experienced traders are partial ETFs because they can be sold short. you believe that Taiwan stocks are ov heated, for example, you can make a b on it by shorting the iShares MSCI Taiw Index Fund. You can also hedge or leve age an ETF position with options—som thing that is impossible with traditior mutual funds.

Which countries and regions shou investors focus on in 2006? Some adv ers recommend a simple strategy of ove weighting Asian markets and unde weighting those in Europe. Chin growth is aiding all of the develop economies in the region, particula Japan and South Korea, while Europe growth remains slow. Investors who b this hypothesis can use ETFs to create long/short trade: long Vanguard's Paci and short European VIPERs.

ETFs can also be used to play the boo in commodity prices. Dave Fry, founder the Web site ETF Digest (www.etf gest.com) and a former managing dire

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HOW TO MAKE THE
PERFECT
AÑEJO PACIFICO

THE PATRÓN
AÑEJO PACIFICO

1 1/2 oz Patrón Añejo Tequila
Juice of one lime (approx 1 oz)
1 oz passion fruit puree

In an ice filled mixing glass add above ingredients, shake until well blended.
Strain into a chilled cocktail glass.
Sweeten to taste.
Garnish with a lime wheel.

TEQUILA
PATRÓN

tor at one of John W. Henry's investment firms, JWH Investment Management Inc., says the iShares MSCI Canada Index fund is a good way to get in on the commodities boom. "As long as natural resources are hot, [Canada] will benefit," he says. Gold bugs, meanwhile, have flocked to the StreetTRACKS Gold Shares fund, launched in November, 2004. In coming years, analysts say, several new funds tied directly to the prices of commodity indexes should emerge. "Everyone is talking about looking for alternative asset classes, and the ETFs we're expecting [would] open up a whole set of possibilities," says K. Sean Clark, chief investment officer at Clark Capital Management Group Inc. in Philadelphia.

Eastern Europe shows particular promise for 2006. The economies of the less-developed regions of Europe are forecast to grow by 5% next year and those of the former Soviet Republics by almost 7%, according to the International Monetary Fund. The iShares MSCI Austria Fund, which is laden with bank stocks, "is the easiest pure play to capture the financing of Eastern Europe," says Roger Nusbaum, a financial adviser in Prescott, Ariz., who writes about ETFs on his blog, Random Roger's Big Picture (randomroger.blogspot.com).

P-E DISCOUNT

EMERGING MARKETS, meanwhile, have been on a tear lately, with the iShares MSCI Emerging Markets Index fund more than doubling since its inception in April, 2003. The Vanguard Emerging Markets VIPERs is up 20% since March. And yet emerging markets trade at a trailing price-to-earnings ratio of 12, according to Bloomberg Financial Markets, well below the S&P 500's 18, with a dividend yield of 2.75%, the S&P's 2%. "There are always going be concerns [with emerging markets says J.D. Steinhilber, president of Agile vestments, an ETF-oriented adviser Nashville, "but as a long-term invest you shouldn't be trying to make diffic timing calls."

China continues to defy predictions a slowdown: The MSCI China index w up 14% in 2005 through Dec. 9. And good times are likely to continue, s Michael Carty, president of New Mille nium Advisors LLC in New York. "Chi

One simple strategy: Load up on robust Asian markets and go light on sluggish Europe

has grown on the advantage of its l wages, but now it's becoming more i dustrialized, and productivity gains a kicking in," he says. There are two Chi plays for ETF investors: iShar FTSE/Xinhua China 25 Index Fu which includes the largest compani trading in China, and PowerShares Gol en Dragon Halter USX China Portfol which includes only companies wh shares are listed in the U.S. New Mille nium's Carty favors the former.

The ETF frontier is ever-expandin One new portfolio, Euro Currency Tru began trading on Dec. 12. It lets investo bet on the euro, with each share of t ETF representing 100 euros. Expect slew of new offerings in 2006, say an lysts. But India is one country that h proved to be a tou nut to crack. T country's capit markets are noto ously difficult to er ulate with a sing market index b cause of the lar number of small-c issues there. An E sponsor ought to a dress that in 200 says Morgan Stanl ETF analyst Pa Mazzilli. "We get i quiries about it the time," he sa With the MSCI Ind Index up 35% 2005 through Dec it's no wonder. ■

ETFs with Plenty of Upside

FUND/SYMBOL	PRICE*	EXPENSES
ISHARES MSCI AUSTRIA INDEX FUND EWO Profiting from growth in Eastern and Central Europe	27.47	0.59
ISHARES MSCI CANADA INDEX FUND EWC Strong currency and commodity gains are boosting stocks	21.91	0.59
ISHARES MSCI JAPAN INDEX FUND EWJ Has room for further gains even after hitting a five-year high	12.93	0.59
POWERSHARES INTERNATIONAL DIVIDEND ACHIEVERS FUND PID Offers a diversified mix of income-producing stocks	15.29	0.40
VANGUARD EMERGING MARKETS STOCK FUND VIPERs VWO An inexpensive play on growth outside developed countries	59.79	0.15%

*9

Data: Bloomberg Financial Markets

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Emerging Markets: Beyond the Big Four

Egypt, Mexico, Poland, South Africa, South Korea, and Turkey are investor-friendly and boast strong growth, too. BY CHESTER DAWSON

THE BIGGEST, FASTEST-growing economies of the Third World are Brazil, Russia, India, and China. But while the Big Four, also known as BRICs, have attracted the most investor attention in recent years, there are also opportunities in less prominent but more promising emerging markets such as Egypt, Mexico, Poland, South Africa, South Korea, and Turkey. They may not have the buzz of billion-plus population markets, but their growth is impressive—and their stocks, in many cases, can offer superior value.

Some pros are wary of India's frothy equity market and mainland China's disclosure-poor companies. Brazil's fragile political situation and Moscow's penchant for interfering in business are also growing concerns. In other words, even within emerging markets it is important to diversify beyond a few core holdings. "The whole notion that you should invest only in BRICs is silly," says Mark Madden, portfolio manager of OppenheimerFunds' Developing Markets Fund.

The six leading non-BRICs are notable for their strong growth profiles, fast-track reform agendas, and investor-friendly climates. Unlike the largely export-dependent BRICs, most of these countries are prospering chiefly on domestic demand from surging consumer spending.

MORE RISK

BRIC OR NON-BRIC, investing in emerging markets poses unique challenges. The lack of liquidity in these markets can be brutal to shareholders since investors in a rush to sell can send prices tumbling. What's more, relatively few shares based in the developing world are listed in the U.S. or traded as American depositary receipts (ADRs). That can make it hard to buy dollar-priced stocks, especially those in line with Securities & Exchange Commission reporting guidelines. An alternative: emerging-market mutual or exchange-traded funds (ETFs), some of which target specific regions or countries. Check out the iShares MSCI Emerging Markets Index Fund or the Vanguard Emerging Markets VIPERs ETF.

For direct exposure south of the border, choices include iShares S&P Latin America 40 Index Fund or MSCI Mexico Index Fund. While Mexico doesn't enjoy t celebrity status of rival Brazil, it is unde going something of an economic rena sance. With its last financial crisis mo than 10 years behind it, Mexico is enjoyi record foreign currency reserves and an i vestment-grade debt rating, thanks much-improved fiscal discipline. It ev boasts several companies listed on t New York Stock Exchange or NASDAQ a dozens of others that trade over the cou er, including Wal-Mart de México. Mon managers are especially keen on stocks the residential construction business more and more Mexicans qualify for loa to build their own homes. These inclu NYSE-listed Desarrolladora Homex a cement maker Cemex. "The home sector very exciting," says OppenheimerFund Madden. "They've got huge unmet d mand for housing."

South Africa has also surprised on t upside largely because of the spending r straint exercised by its government. Whi the country has long been viewed as a on trick pony for precious-metals stocks, strong currency has dimmed prospects f commodity and other export plays. I stead, the smart money is looking for o

Little-Known Opportunities

STOCK / SYMBOL	PRICE*
AGORA AGO.PW This Polish media company is benefiting from an advertising boom	15.26
AKBANK AKBTY.PK An explosion in Turkish consumer and corporate credit makes the bank a good bet	15.29
DESARROLLADORA HOMEX HXM Robust demand for housing in Mexico has this developer in high gear	30.26
EDGARS CONSOLIDATED STORES ECO.SJ A multiformat retailer, it's a play on South Africa's strengthening consumer sector	5.25
KOREA ELECTRIC POWER KEP Domestic-oriented stocks, such as this electric utility, are poised for growth	18.20

* Dec. 9

Data: Bloomberg Financial Markets, BusinessWeek

WARSAW Countries closest to adopting the euro are favored —and Poland tops the list

ortunities in domestic-oriented sectors ich as retailers and consumer banks. hose with ADRs traded over-the-counter clude shoe distributor Edgars Consoliated Stores Ltd. and bank ABSA Group td. There is also an iShares ETF, the MSCI outh Africa Index. "We've seen a rotating it of mining into more domestic names," ys Julie L. Pfeffer, a senior analyst at uPont Capital Management in Wilmingn, Del., which has $600 million invested emerging-market equity, including outh African shares.

Another popular African stock market Egypt's, which has been among the est performers—up 640% in U.S. dollars ver the past three years. That's due both the stepped-up pace of economic reorms in the country and an influx of etrodollars from Gulf states awash in ash from higher oil prices. Commercial nternational Bank, a leading commercial ank and a favorite of stockpickers, is also ne of the few Egyptian shares available s an ADR.

Eastern Europe, from the Baltic to the alkans, is likewise blossoming thanks to eforms put in place after the collapse of e Iron Curtain. The countries closest to dopting the euro as their currency are faored—and Poland is at the top of that st. While a laggard this year—it's up nly 21% in U.S. dollars—Poland serves a cheaper proxy for Western Europe nce its fortunes are closely linked to those of Germany, the Continent's largest economy. Among the stars: Polish media companies, which are benefiting from an advertising boom and have "great growth potential," says Emery Brewer, the Prague-based portfolio manager of the Driehaus Emerging Markets Growth Fund. Agora, a leading Polish newspaper and radio concern, is among the few stocks traded over the counter in the U.S.

Turkey is eager to join the European Union and is pushing economic reforms.

> Caveat: The lack of liquidity can be brutal if investors in a rush to sell send prices tumbling

The nation also boasts a younger workforce than most of nearby Eastern Europe. The country is home to a thriving manufacturing base serving both Western Europe and the Middle East. Turkey's banks are profiting handsomely from an explosion of corporate and consumer lending. Those with OTC ADRs include Akbank. "Turkish banks have done very well and are likely to continue to do so," says Michael L. Reynal, a London-based portfolio manager at Principal Global Investors, which has $1.6 billion invested in emerging markets. "They are seeing huge loan growth."

During the last big bull market for emerging markets a decade ago, Southeast Asia led the pack. But even after a wrenching correction in the wake of the 1997 financial crisis, these so-called Asian Tigers have consistently underperformed their global peers. "The stars of the past haven't been able to reinvent themselves and are now being squeezed by China and India," says Ruchir Sharma, co-head of global emerging markets at Morgan Stanley Investment Management in New York. South Korea, though, has just begun to pull out of a tailspin. While powerhouses such as Hyundai and Samsung Group are must-haves, more domestic outfits, such as OTC-traded Kookmin Bank and Korea Electric Power, may be poised for growth. The iShares MSCI South Korea Index Fund is also worth considering.

While few market hands see red flags in the emerging world, success could breed the kind of complacency that got the Tigers into trouble in the 1990s. Even so, developed nations can't match the growth of emerging economies. "The decade could belong to emerging markets," says Morgan's Sharma. "And we're only halfway through."

[WHERE TO INVEST]

Smart Strategies

Looking for a new investment direction? Look no further

HEDGE FUNDS >> P. 98
By carefully pairing mutual funds, you can grow your own—and keep all the profit

INCOME INVESTING >> P. 100
As interest rates rise, municipal bond funds may prove a safe haven

ASSET ALLOCATION >> P. 104
The rules of rebalancing your portfolio

FUNDS >> P. 106
All aboard the growth train

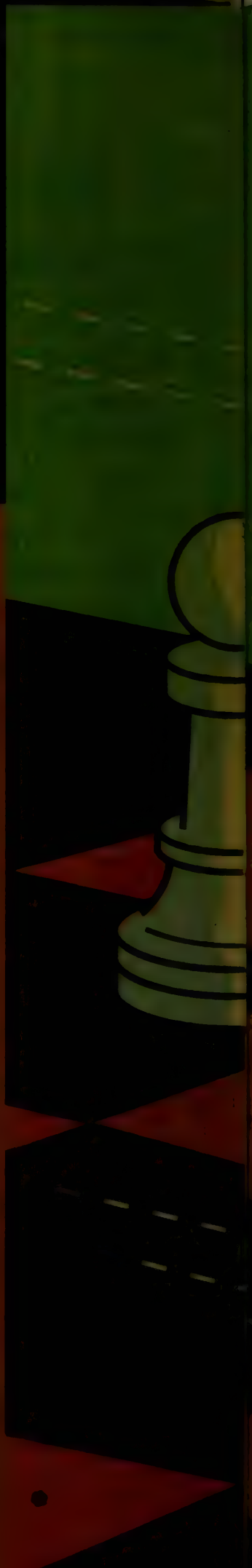
R&D >> P. 110
Looking for the Next Big Thing? Keep an eye on the companies with quality patents

MERGER >> P. 114
Why M&A action should accelerate in 2006

REAL ESTATE >> P. 118
There are still pockets of value out there

INFLATION >> P. 123
Don't let down your guard. Check out gold, commodities, and more

COLLECTING >> P. 124
Today's art market looks awfully inflated



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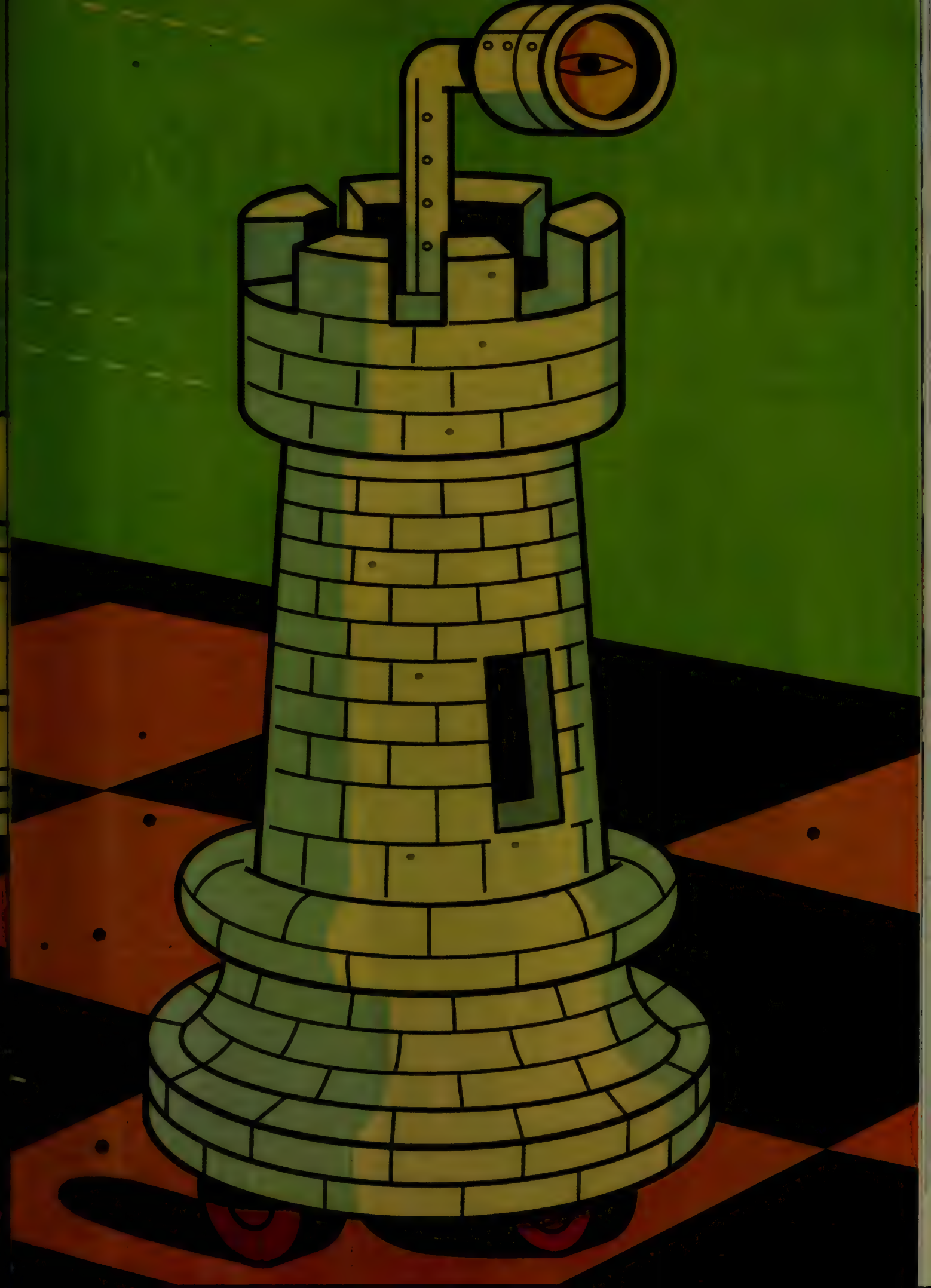


How to Build Your Own Hedge Fund

It's surprisingly easy to set up, you can keep costs down, and you won't have to share the profits. BY LEWIS BRAHAM

IF P.T. BARNUM WERE ALIVE today he would be a hedge-fund manager. Who needs suckers to go to the circus when you can collect 1% or 2% of their money per year and 20% or 30% of their winnings from the comfort of your office in Greenwich, Conn.? No profits? No problem. Close up shop, reopen under another name, and big institutional investors and wealthy individuals will still throw money at you.

If you want to invest in a hedge fund there's no need to bother with these gun slingers. Using mutual funds, you can put together a hedge fund yourself at a lower cost and without having to share your profits. With this personalized approach you can also manage the fund with taxes in mind. Unlike hedge funds, which may require multiyear lockups or give only intermittent access to the money, you will have immediate liquidity. And mutual funds, while not totally scandal-free, are better regulated.

It's relatively easy to simulate a classic hedge-fund strategy in which a manager invests a portion of his assets in stocks he likes—the long side of the portfolio—and simultaneously shorts or bets against stocks he doesn't like. For the long side, you could invest 50% of your "hedge fund" stash in a well-regarded mutual fund, such as the Fairholme Fund. Fairholme has a relatively low 1% expense ratio and a 14.82% five-year average annual total return. Then take the other 50% and invest it in one of the 27 short mutual funds available—say, Prudent Bear Fund, which has a 1.83% expense ratio and a 10.02% five-year number. Com-

bined they have a moderate 1.42% expense ratio and a 12.42% five-year return, which, according to tracker CSFB/Tremont, more than doubles the 5.20% average return for long-short hedge funds for the period ended Oct. 31.

The biggest additional advantage may be for taxable investors. Consider a 50-50 combination of Meridian Growth and Prudent Bear funds. In 2002's bear market, Prudent Bear was up 62.87% while the Meridian Growth Fund was down 17.82%. Combined, they would have had a 22.53% return. Yet at the end of the year you could have sold your Meridian Growth shares and used the losses to offset any taxable gains in your portfolio. In a long-short hedge fund with the same 22.53% return, you are entirely dependent on the manager to do that for you. This combined-fund strategy is particularly effective because long funds tend to be up when short funds are down, and vice versa. So in 2003's rally, Meridian gained 47.90% while Prudent fell 10.44% for a combined 18.73%. What's also important is that in creating your own hedge fund, you can time gains and losses to maximize your tax advantage.

THE BUDDY SYSTEM

OF COURSE, HINDSIGHT is 20/20. The Fairholme Fund is a value fund whose investment style has been in favor for the last five years, so its returns combined with a short fund's look good. Yet such hindsight also applies to the hedge-fund universe. Only their higher fees, not their future performance, are for certain.

What's more, the sheer number of long equity mutual funds and the growing number of short ones allows you to employ many different hedging strategies. For example, blue-chip stocks have been out of favor in recent years while small caps have soared, and there is evidence that relationship is changing. You could buy the Brandywine Blue Fund, which, though a top performer in its large-cap growth category, earned an average annualized return of only 1.39% over the past five years, and combine it with ProFunds Short Small Cap Fund, which shorts the Russell 2000 index of small-cap stocks.

> One of the biggest benefits of a homegrown hedge fund: Shaving your tax bill is simple

Supposedly, the least risky long-short hedge funds are the "market-neutral" ones. Such funds are always equally long and short while other hedge funds may vary their positions. In addition, market-neutral funds often match their longs with their shorts. So if a fund has 10% of its assets in auto stocks on the long side, then it will have 10% in auto stocks on the short. That makes the fund's performance dependent on the manager's stock picking skills rather than broad industry or market trends.

Such a strategy is harder to replicate with two separate funds because the longs and shorts are chosen by different managers. "If you combine a short fund with the Fairholme Fund, you may eliminate some of the bear-market risk to your portfolio, but not the stock-specific risks of the Fairholme Fund," says Rick Lake of Lake Partners Inc., a Greenwich money-management firm that employs hedging strategies. For this reason, Lake prefers long-short mutual funds that hedge internally. Some of those are in the table on page 100. The table also includes funds that practice strategies that are hard to mimic with two separate funds, such as merger arbitrage.

That said, you can come close to a market neutral strategy by sticking to a 50-50 long/short position and finding a suitable match for the short side. Consider a pairing of Masters' Select Smaller Companies Fund with the ProFunds Short Small Cap Fund. The Masters' Select fund parcels out management to five top-performing small-cap fund managers, each of whom chooses 10 to 15 stocks for the fund. The portfolio is diversified by the managers' different investment styles, making the fund a good match for the diversified ProFunds portfolio.

Another approach is to go long and short in different market sectors. If you use an index short fund, choose one from a different, less promising sector than your long fund. For instance, since the Federal Reserve started raising rates 18 months ago, real estate investment trusts have trounced bank stocks to the point that many market seers consider REITs expensive and banks cheap. So you could

Mutual-Fund Matchmaking

By carefully pairing funds, you can design a hedge fund the way the pros do. Here are some possible combos:

LONG FUND / SYMBOL SHORT FUND / SYMBOL	COMBINED 5-YR RETURN*	COMBINED EXPENSE RATIO**
BRANDYWINE BLUE BLUEX **PROFUNDS SHORT SMALL CAP** SHPIX » **The Bet:** Blue-chip stocks beat small caps	N/A	1.32%
FAIRHOLME FAIRX **PRUDENT BEAR** BEARX » **The Bet:** One side buys cheap stocks, the other shorts expensive stocks	12.42	1.42
MASTERS' SELECT SMALLER COS. MSSFX **PROFUNDS SHORT SMALL CAP** SHPIX » **The Bet:** Market-neutral play on the small-cap market	N/A	1.46
MERIDIAN GROWTH MERDX **PRUDENT BEAR** BEARX » **The Bet:** One side buys fast-growing companies, the other sells likely losers	9.53	1.35
OAKMARK INTERNATIONAL OAKIX **RYDEX URSA** RYURX » **The Bet:** Foreign stocks perform better than U.S.	6.49	1.29
POLARIS GLOBAL VALUE PGVFX **PRUDENT BEAR** BEARX » **The Bet:** Both sides have great flexibility in what they buy and sell	12.95	1.66
SENBANC SENBX **PROFUNDS SHORT REAL ESTATE** SRPIX » **The Bet:** Bank stocks beat REITs	N/A	1.50
T. ROWE PRICE GLOBAL TECH. PRGTX **PROFUNDS SHORT OIL-GAS** SNPIX » **The Bet:** Tech stocks beat energy	N/A	1.55
VANGUARD ENERGY VGENX **RYDEX ARKTOS** RYAIX » **The Bet:** Energy stocks beat tech	12.95	0.84

*Returns are average annualized returns for the two funds including reinvestment of all dividends and capital gains as of Oct. 31, 2005
**Average expense for the two funds as of Oct. 31, 2005

Data: Morningstar Inc.

pair top-performing bank-stock fund Senbanc Fund with the ProFunds Short Real Estate Fund. Think tech stocks are attractive but energy's best days are behind it? Buy T. Rowe Price Global Technology Fund and ProFunds Short Oil-Gas Fund. Do you think that foreign stocks are cheaper than U.S. ones? Combine Oakmark International Fund and Rydex Ursa Fund, which shorts the Standard & Poor's 500-stock index. The number of combinations is limited only by your imagination. There may be plenty of suckers, but you needn't be one of them. ■

One-Stop Shopping

Not every hedge fund strategy can be easily replicated by do-it-yourself investors. Here are some mutual funds that do it for you.

FUND/SYMBOL COMMENTS	EXPENSE RATIO
ARBITRAGE FUND ARBFX Invests in merger arbitrage	1.95%
BRIDGEWAY BALANCED BRBPX Sells covered calls	0.94
CALDWELL & ORKIN MARKET OPPORTUNITY COAGX Picks longs and shorts	1.79
GATEWAY FUND GATEX Sells covered call options	0.97
HUSSMAN STRATEGIC GROWTH HSGFX Opportunistic long-short	1.15
METROPOLITAN WEST STRATEGIC INCOME MWSTX Bond-market arbitrage	2.22*
MUTUAL RECOVERY FMRAX Buys distressed debt	3.02*
PENNSYLVANIA AVENUE EVENT-DRIVEN FUND [illegible]** Merger arbitrage and distressed debt	1.50
PIMCO COMMODITY REAL RETURN STRATEGY PCR[illegible] Commodities	[illegible]4
UBS ABSOLUTE RETURN BOND BNRAX Long-short bonds and currencies	1.00

*Metropolitan West Strategic Income and Mutual Recovery have [illegible] that [illegible] depending on their performance
**[illegible] no ticker symbol. Go to www.pennavefunds.com for more information. Data: Morningstar Inc. and fund companies

Don't Come Up Empty-Handed

It's hard to find fat yields in this arena, but here's a clutch of ideas. BY ADRIENNE CARTER

LOOKING FOR INCOME IN this interest-rate environment is frustrating. The yield curve is flatter than a pancake, so short-term rates on Treasuries are practically in line with long-term rates. And although many pundits agree that the Federal Reserve Board will modestly hike rates in the beginning of 2006, that gap is likely to remain pretty small. At the same time, there are a lot of uncertainties—like inflation, the housing market, and foreign demand for U.S. bonds—and all that is making the bond market skittish. "We're in the late stages of Fed tightening, which has a way of making the market kind of hazardous," says George Fischer, a bond fund manager with Fidelity Investments.

So what do you do for income? Since you're rarely rewarded in this market for taking on more credit risk, higher-quality fixed-income issues rule. That's true across the bond world. You need to consider mining the equity markets for yield, too. "You have to look at multiple sources, not just the standard instruments," says Scott Powell, managing director of Virchow Krause Wealth Management.

Considering that, we explored the entire spectrum of income-oriented investments. What follows are some of the best opportunities in a market that's not all that rewarding.

» SHORT-TO-INTERMEDIATE INVESTMENTS

These days you won't get much bang from a bond with a longer maturity. In fact, there is essentially no gap between the yield on the two- and five-year Treasuries, with both at around 4.4%. A 30-year bond offers only an extra 0.30 percentage points.

Given that, it makes sense to stay on the shorter end of the maturity spectrum and in high-quality securities from top-drawer borrowers. "This is an environment where income investors don't want to do anything too heroic," says Warren D. Pierson, senior portfolio manager at Robert W. Baird & Co.

Buying individual Treasuries is simple and a virtually cost-free way to invest in the shorter end. But use mutual funds if you want to invest in corporate income securities. By doing so, you'll avoid the risk that company-specific news sends your investment reeling, such as the financial woes at Ford Motor Co. and General Motors Corp.

One approach is a mutual fund like Metropolitan West Total Return Bond Fund. It includes U.S. government, corporate, and mortgage bonds, and has a duration of 3.9 years—meaning that the fund will decrease in value by roughly 3.9% if interest rates rise by 1% and increase 3.9% if rates do the reverse. That compares with a duration of 4.6 years for the Lehman Brothers U.S. Aggregate Bond index. Management has also limited the interest-rate risk by owning a number of less interest rate-sensitive investments like bank loans. The fund yields 5.87%.

> Think high-quality fixed-income issues—since there's no reward for taking on added credit risk

Even a bank certificate of deposit can be attractive. You won't necessarily find the highest yield at your neighborhood branch, so compare rates at a site like Bankrate.com. A one-year CD at Corus Bank in Chicago recently had a rate of 4.75% vs. a 4.11% national average.

value of its holdings, or net asset value (NAV). Managed Municipals Portfolio, run by bond veteran Joseph Deane, is a high-quality offering and trades at a 10.93% discount. Nuveen Quality Income Municipal Fund has an 8.65% discount and a 6.02% yield.

» BANK LOAN FUNDS You can get yields of around 5% in a bank loan fund, which buys floating-rate corporate loans. The interest rates on the loans move up and down with short-term rates, so the funds' NAVs are fairly stable.

Given the recent moves by the Fed, the yields on bank loan funds are at their highest level in years, and they're fatter than those of money-market funds and ultra-short bonds. The extra yield, though, comes from credit risk. The loans in these funds are typically not rated or rated below investment grade.

Fidelity Floating Rate High Income Fund, which is yielding 4.90%, is among the highest-quality offerings. The no-load fund invests mainly in the loans of larger companies, and it keeps a nice stash of cash for liquidity. Eaton Vance Floating-Rate Fund, at 5.12%, has one of the most seasoned management teams in the field.

The sector has had a nice run in the past few years, so don't bank on price appreciation to boost returns. If the Fed stops hiking rates, the funds' yield will stop going up. Still, says Morningstar Inc. analyst Scott Berry, a bank-loan fund "is a good balance to a high-quality, interest rate-sensitive portfolio."

» MUNICIPAL BONDS Foreign investors have been gobbling up long-term U.S. Treasuries, helping keep prices up and yields down. But they buy municipals, a sector dominated by individual investors seeking the tax-free income. That's one reason why muni yields haven't moved in tandem and thus look better on a tax-equivalent basis. A 10-year insured muni yields 4.04%, vs. 4.55% for a 10-year Treasury. For an investor in the 28% tax bracket, that's like earning 5.61% on a taxable bond. Assuming a 35% tax rate, the equivalent yield jumps to 6.22%.

The same advantages hold true with muni bond funds. Vanguard Intermediate-Term Tax-Exempt Fund and USAA Tax Exempt Intermediate-Term Fund have current yields of 4.06% and 4.17%, respectively. The tax exemption boosts those numbers to 6.25% and 6.42% for top taxpayers. Closed-end funds offer even potentially higher rewards, 5% to 6% tax-free. But such funds often use leverage, borrowing money to buy more and enhance yields. So higher short-term rates can crimp a fund's ability to keep up that dividend.

As with most closed-end funds, buy only when it trades at a discount to the

» DIVIDEND-PAYING STOCKS Many companies have record stashes of cash, and shareholders want more of it. Some CEOs and boards are listening, upping their dividends or offering one for the first time. According to Standard & Poor's (like *BusinessWeek*, owned by The McGraw-Hill Companies), 280 companies have increased their dividend so far this year, up from 272 in 2004.

What's more, we could see even high-

er payouts, according to Duncan W. Richardson, chief equity investment officer for mutual fund firm Eaton Vance Corp. The typical company in the Standard & Poor's 500-stock index pays out one-third of a historical 50%. That means there's room to hike the payouts.

Today, it's not hard to find dividend yields of 3% to 5% on blue-chip companies. Megabanks such as Citigroup Inc. and Bank of America Corp. yield 3.62% and 4.15%, respectively, well above the S&P 500's 1.78% average. Battered pharmaceutical stocks also look appealing, says John Buckingham of the Al Frank Funds. On top of their yields, their low prices mean many have the potential for decent capital appreciation—giving them a heftier overall return. Pfizer, for instance, yields 3.62% and just announced a 26% dividend increase.

A good way to get a diversified portfolio of dividend payers is through an exchange-traded fund. The iShares Dow Jones Select Dividend Index Fund owns roughly 100 of the market's biggest payers, with a heavy dose of financials, pharmaceuticals, and utilities. Its recent yield was 3.9%. The brand-new SPDR Dividend ETF owns top-paying companies that have consistently increased their payouts. It tracks the S&P High Yield Dividend Aristocrats index, which yields 3.3%.

» OPTION INCOME FUNDS It's pretty rare to find yields of 8% to 10% in this market. But for investors who are willing to take on more risk, option income funds are a good choice. These largely closed-end funds employ what's known as a covered-call strategy, buying stocks and then selling options on those stocks for which they receive a payment. Today, many sell at a discount to their NAVs.

Such discounts aren't the result of poor performance, says Mariana F. Bush, a fund analyst at Wachovia Securities LLC, but rather the flood of new funds on the market and investors taking yearend losses. Eaton Vance Enhanced Equity Income and NFJ Dividend, Interest & Premium Strategy Fund have sizable discounts, and have yields of 8.69% and 9.86%, respectively. BlackRock Global Opportunities Equity Trust trades 6.3% below its NAV and has a yield of 10.33%.

To get that extra yield, investors give up some upside potential. So performance may lag behind traditional stock funds if the market rallies. Even though the income makes them less volatile than most equity funds, they're not immune from bad stock selection.

» INCOME DEPOSIT SECURITIES/INCOME TRUSTS An up-and-coming investment idea, Income Deposit Securities (IDSs) offer yields of up to 14%. IDSs are part stock and part bond. That means roughly half the yield comes from the stock dividend, which is taxed at the maximum tax rate of 15%. The remaining portion comes from bond payments, taxed at your regular income tax rate.

Right now, most Income Deposit Securities are issued by small but cash-rich companies, says Neil George, editor of *Personal Finance*, an investment newsletter. The yield on OTELCO Inc., a rural phone company, is just north of 10%. Centerplate Inc., which runs concession stands at sports stadiums and other venues, pays 13.22%.

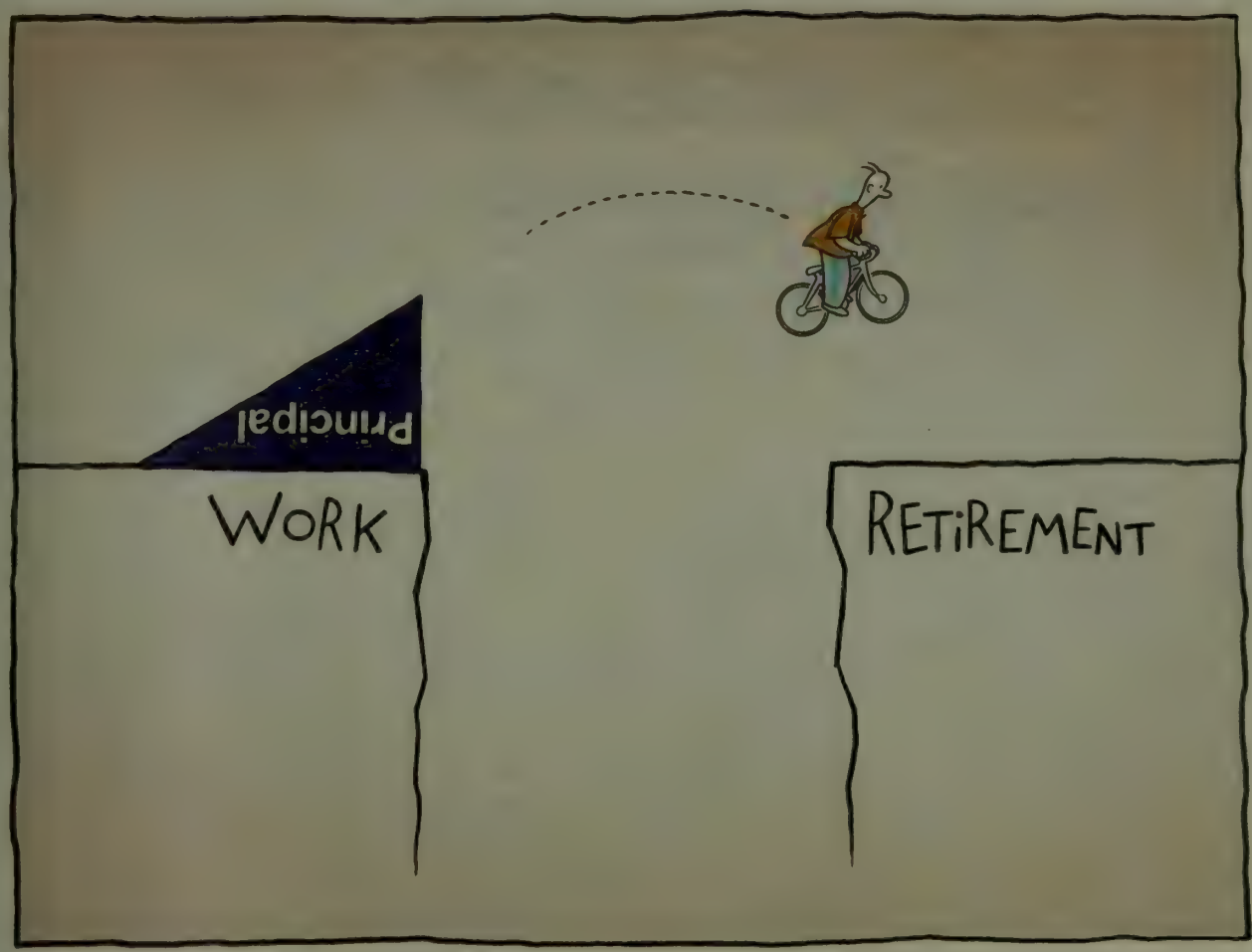
There's another opportunity to pick up yields higher than 10%, up north with Canadian Income Trusts. These trusts pay out a large chunk of their earnings, usually on the order of 60% to 80%. Like an IDS, income or royalty trusts tend to be from cash cows, typically in the natural resources sector. For example, ARC Energy has a dividend of 8.84%, while NAL Oil & Gas pays 12.2%. You can find some outside of energy, including beermaker Big Rock Brewery (7% yield) and trucking and logistics company TransForce (7.73%). In today's yield-starved market, they are filling fare. ■

Desperately Seeking Income

In this interest-rate environment, you'll have to be creative to find higher yields. Here are some moves you can make:

SHORT-TO-INTERMEDIATE-TERM INVESTMENTS		YIELD*
METROPOLITAN WEST TOTAL RETURN BOND MWTRX		5.87%
ONE-YEAR CD, CORUS BANK		4.75
TWO-YEAR U.S. TREASURY NOTE		4.43
SIX-MONTH U.S. TREASURY BILL		4.30
MUNICIPAL BONDS		
AA MISSISSIPPI GENERAL OBLIGATION 5%	2010	4.71%
AAA CHICAGO, ILL. GENERAL OBLIGATION 4%	2016	4.05
MUNICIPAL BOND FUNDS		
NUVEEN QUALITY INCOME MUNICIPAL NQU		6.02%
MANAGED MUNICIPALS PORTFOLIO MMU		5.29
USAA TAX EXEMPT INTERMEDIATE-TERM USATX		4.17
VANGUARD INTERMEDIATE-TERM TAX-EXEMPT VWITX		4.06
BANK LOAN FUNDS		
EATON VANCE FLOATING-RATE EVBLX		5.12%
FIDELITY FLOATING RATE HIGH INCOME FFRHX		4.90
DIVIDEND STOCKS		
BANK OF AMERICA BAC		4.15%
CITIGROUP C		3.62
PFIZER PFE		3.62
DIVIDEND FUNDS		
ISHARES DOW JONES SELECT DIVIDEND INDEX DVY		3.90%
SPDR DIVIDEND ETF SDY		3.30**
OPTION INCOME FUNDS		
BLACKROCK GLOBAL OPPORTUNITIES EQUITY TRUST BOE		10.33%
NFJ DIVIDEND, INTEREST & PREMIUM STRATEGY NFJ		9.86
EATON VANCE ENHANCED EQUITY INCOME EOI		8.69
INCOME DEPOSIT SECURITIES		
CENTERPLATE CVP		13.22%
OTELCO OTT		10.10
INCOME TRUSTS		
NAL OIL & GAS NAE-U		12.20%
ARC ENERGY AET-U		8.84
TRANSFORCE TIF-U		7.73
BIG ROCK BREWERY BR-U		7.00

*Yield based on the index tracked by the ETF **Data:** Bloomberg Financial Markets, Morningstar, S&P



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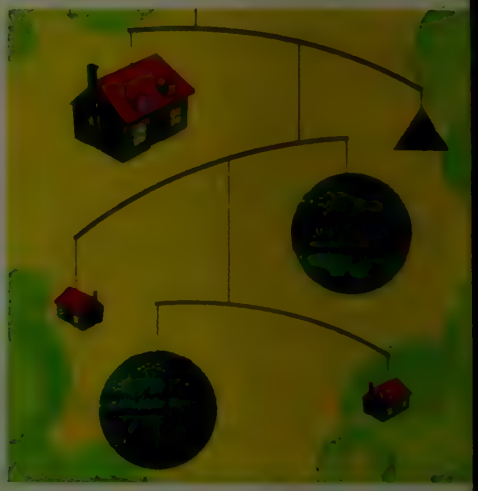
Set a Course For Higher Returns

Letting your portfolio drift too far off target can cost you. BY ANNE TERGESEN



A DIVERSIFIED ASSET allocation plan can help you ride out the market's ups and downs without too much anxiety. But even the most smartly conceived portfolio needs to be adjusted now and then to keep it from drifting off course. That means rebalancing—or trimming your winners and bulking up on your losers until your portfolio once again conforms to your plan. Yearend is a good time to do it, especially if you'll be making changes in a taxable account.

Yes, selling winners and buying losers is counterintuitive. But disciplined rebalancers are likely to earn higher returns than those who let their portfolios get out of whack. One reason: Rebalancing helps ensure you won't become overexposed to asset bubbles or have too little in laggards to make a difference when a rebound arrives. By preventing a portfolio from going to extremes, this exercise also smooths returns, which allows them to compound more steadily. "You can make a very material difference in your savings over time by rebalancing and getting your asset allocation right," says Marc O. Mayer, chairman of AllianceBernstein Investment Research & Management Inc.

For simplicity's sake, there's a lot to be said for making your moves by the calendar—say, once a year. But if you want to eke out the most you possibly can, rebalance the way many institutions do—whenever a position deviates significantly from your allocation plan. Of course, how you trade matters, too: To minimize commissions and tax bills, do as many transactions as possible inside individual retirement accounts (IRAs) and 401(k)s. Better still, rather than selling taxable winners, try to get your portfolio back in line by funneling new contributions into underrepresented assets.

TRIGGER POINTS

TO REBALANCE the institutional way, you've got to decide how much to allow your positions to shift. For most investors, Alliance calculates, it's a good idea to take action when the percentage of your assets in bonds strays by about three percentage points from your target. For example, if your plan calls for having 30% in bonds, you'll need to start buying when your allocation dips to 27% and selling when it rises to 33%. For equities, which are more volatile, the trigger point is five percentage points. That's where the expected benefits of keeping your portfolio on plan outweigh the costs of reshuffling.

These ranges are not set in stone. Indeed, someone with a high risk tolerance can let the holdings drift more—say, up to 10 percentage points—thereby saving on transaction costs, says David Rosenberg, head of U.S. investment solutions at Citibank's private bank, which also uses ranges. Likewise, to avoid realizing short-term capital gains, an investor in the highest marginal tax bracket should use slightly higher triggers. If you're trading in an IRA or 401(k), you can act a little sooner—when your bonds stray by two percentage points and stocks by four.

Consider a fairly standard portfolio with 30% in U.S. bonds, 25% in U.S. growth stocks, 25% in U.S. value stocks, and 20% in international stocks. An Alliance study shows that between 1997 and the end of 2002, rebalancing using trigger points would have yielded 0.6% more a year than if the portfolio was never adjusted. (In part to reduce the tab for commissions and tax bills, Alliance rebalances only halfway to target allocations. That means if you want 50% in equities but have 55%, you would trim to 52.5%.) By using an annual approach, you would still outperform, but by about half as much. The estimated gains may be a bit lower now since the markets are less volatile than when Alliance did its study.

Regardless of how you rebalance, do it in cost-effective ways. For example, to reduce taxes, harvest losses to offset your capital gains, says Jack Caffrey, equity strategist at JPMorgan Private Bank. (Of course, replace what you sell with similar investments.) Remember that how you rebalance is just as important as when. ■

The Rules of Rebalancing

Here are some ways to help you keep your portfolio well-tuned

DECIDE HOW YOU WANT TO REBALANCE Many go by the calendar—say, once a year. Others readjust a position whenever it deviates significantly from an asset allocation plan.

STICK WITH IT If you don't rebalance, you risk becoming overexposed to winners that may be ready for a fall and underexposed to laggards that may be ready to rally.

BE FLEXIBLE If you use an annual approach, but a position has only strayed a little bit from your plan—say, by under three percentage points for bonds or under five for stocks—leave it be in order to save on trading commissions and taxes.

TRADE IN TAX-EFFICIENT WAYS Harvest losses in order to offset capital gains or rebalance inside your 401(k) or IRA.

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All Aboard The Growth Train

Mutual funds play up emerging markets, natural resources, and tech. BY LAUREN YOUNG

MUTUAL FUND MANagers have been calling for a rebound in growth stocks for more than a year. With growth funds beating value—finally—in 2005, fund managers say the streak should continue well into 2006. "Our bet right now is on growth stocks," says Gina Sanchez, who oversees American Century Investments' Strategic Asset Allocation funds.

Growth funds, which focus on companies with strong earnings momentum, still have a long way to go to make up for years of losses. But investors who hold a good mix of funds—growth, value, small-cap, large-cap—have nothing to complain about. The average U.S. diversified fund rose 7.7% in 2005, beating the total return of 5.7% for the Standard & Poor's 500-stock index through Dec. 9.

Thanks to high oil prices, natural resources funds continued to soar, rising 43%, while more diversified emerging-markets stock funds gained 29.2%. Because so many commodities come from Latin America, funds investing there soared 54%. That makes Latin American equities the best-performing category of funds. Overall, it was a winning year: The only losses came from world bond funds, which fell 3%.

Among growth funds, managers expect larger companies to shine in 2006 after a six-year streak of small-company outperformance. "It's time for large caps," says Robert Stimpson, co-manager of the Rock Oak Core Growth Fund. That's because plenty of big companies have gotten their finances in order in recent years. Many are paying down debt, repurchasing stock, and building up hefty cash cushions. After climbing toward the stratosphere in 2000, large-company stock prices are back to reasonable levels.

Yet smaller companies, which tend to lead the way out of an economic recovery, should lose some momentum, especially if interest rates continue to climb. "At some point, higher interest rates will hurt smaller firms that are more prone to higher funding costs," Stimpson says.

The Giant Equity Funds

FUND	ASSET (BILLIONS)	TOTAL RETURN*
VANGUARD 500 INDEX INV.	$68.1	5.61%
GROWTH FUND OF AMERICA A	67.8	14.17
INVESTMENT CO. OF AMERICA A	64.9	6.83
WASHINGTON MUTUAL INV. A	61.3	4.17
FIDELITY CONTRAFUND	55.0	17.20
FIDELITY MAGELLAN	50.7	6.44
S&P DEPOSITARY RCPTS.	49.6	5.63
DODGE & COX STOCK	49.2	8.91
INCOME FUND OF AMERICA A	47.3	2.29
CAPITAL INCOME BUILDER A	42.3	3.19

*Appreciation plus reinvestment of dividends and capital gains before taxes, Dec. 31, 2004 through Dec. 9, 2005

Data: Standard & Poor's

Many growth fund managers are putting technology stocks at the top of their shopping lists. That's quite a turnaround, considering that most tech companies looked like toxic waste after the stock market crashed in 2000. "For the first time in quite a while, we are on the verge of a decent cycle in [information technology] spending," says Scott Schoelzel, manager of the Janus Twenty and Janus Forty funds. After ignoring technology for the past four years, he is giving the sector, particularly software companies, a serious look.

> Many fund managers are putting technology stocks at the top of their shopping lists

Other growth fund managers are moving in with a vengeance. Robert Smith, manager of the T. Rowe Price Growth Stock Fund, has been loading up on blue chip tech names like EMC, Dell, and Intel. Smith's rationale: Cash-rich companies need to upgrade their computer systems and software. "In the next year, capital spending will be better than consumer spending," he predicts.

A WIRELESS BET

AS A RESULT, MICROSOFT CORP. is one of the fund's top holdings because it has new products in the pipeline, including an update of its Office software and the launch of its next PC operating system, Vista, scheduled for 2006. "Software releases are very profitable," Smith says.

John Wallace, portfolio manager of the RS MidCap Opportunities Fund, takes a different spin on the tech spending bet. He likes semiconductor companies, including Advanced Micro Devices, Cypress Semiconductor, Marvell Technology Group, and Broadcom, which are poised to capture the explosion in demand for wireless communications. "When you look at all of the hot new products, including iPods and cell phones, all of them are using applications that require chips," Wallace says.

It also helps that tech companies are in better financial shape. Dell, Intel, and Microsoft are repurchasing stock, which should boost stock performance. "In the tech space, there's a lot of interesting activity going on," says Legg Mason Value Trust manager Bill Miller, who recently upped his tech holdings.

The good news for investors is that it's probably not too late to get in: The typical tech fund rose a modest 6.9% in 2005, with most of those gains occurring in the second half of the year.

Drilling down to other sectors, fund managers say high energy prices are creating some buying opportunities. Beneficiaries of higher energy prices can be found in some unusual places, too. For example, Don Hodges, manager of the multi-cap Hodges Fund, likes train oper

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ator Burlington Northern Santa Fe Corp. "The coal business is booming," Hodges says. Coal production is up because natural gas is so expensive, and this bodes well for railroads, since they are the primary transporters of coal. Railroads are also benefiting from global consumption trends since shipping containers laden with goods from China and other exporting nations need to be dispersed across the U.S., Hodges says.

BANKING ON JAPAN

SUCH INCREASED demand for products from Asia helped push diversified Pacific/Asia funds up 23.4% in 2005. Fueling the gains in the region is Japan: Japan funds rose 24.2% for the year. "Japan has come a long way," says William Kennedy, manager of the Fidelity International Discovery Fund. Kennedy says the Japanese market has plenty of catalysts to continue to climb in 2006, including banking reforms, high domestic consumption, and a strong export base.

One Japanese export play is heavy-equipment maker Komatsu. Roughly 40% of the company's sales come from the emerging markets. "It's the Caterpillar of Japan," says Paul Blankenhagen, co-manager of Principal Investors Diversified International Fund. New products should help boost Komatsu's operating margins from 7% to 11% this year, he says.

Because the Japanese banking system is undergoing serious reform, Blankenhagen also likes Sumitomo Mitsui Financial Group. "Loan growth is going from negative territory to positive," he says. When the Bank of Japan starts raising interest rates—which could happen in 2006—banks will make more money lending, he notes.

The outlook is a lot less rosy for fixed income as interest rates continue to climb: "There's far less room for a bond market rally," says Mary Miller, director of fixed income at T. Rowe Price Group. Bonds treaded water for the year, with the typical fixed-income fund gaining 1.6%.

There are a few select opportunities, however. Steven Lear, manager of Schroders U.S. Core Fixed Income Fund, favors cash. "We think the surprise one year from now could be that cash is the best investment," Lear says. "Yields on alternative investments don't necessarily reward for the risk." The average money market fund yields 2.7%, up from 1.5% a year ago, according to Bankrate.com.

Bond fund managers are also sniffing around the muni-bond market. "In a higher-rate environment, intermediate-term municipals will outperform taxable bonds," says Steven Permut, head of the municipal-bond team at American Century. Credit quality from municipalities remains strong, thanks to rising home valuations and higher tax revenues.

Even if home prices come down, money managers aren't worried because high consumption and the tight labor market are boosting sales and personal income tax revenues, too. As a result, managers at both T. Rowe Price and American Century have been putting municipal bonds into taxable bond funds. While those funds do not need the tax break that municipal bonds offer, it's a sign that tax-free bonds are a pretty good deal. ■

Bond Funds Remain in the Black

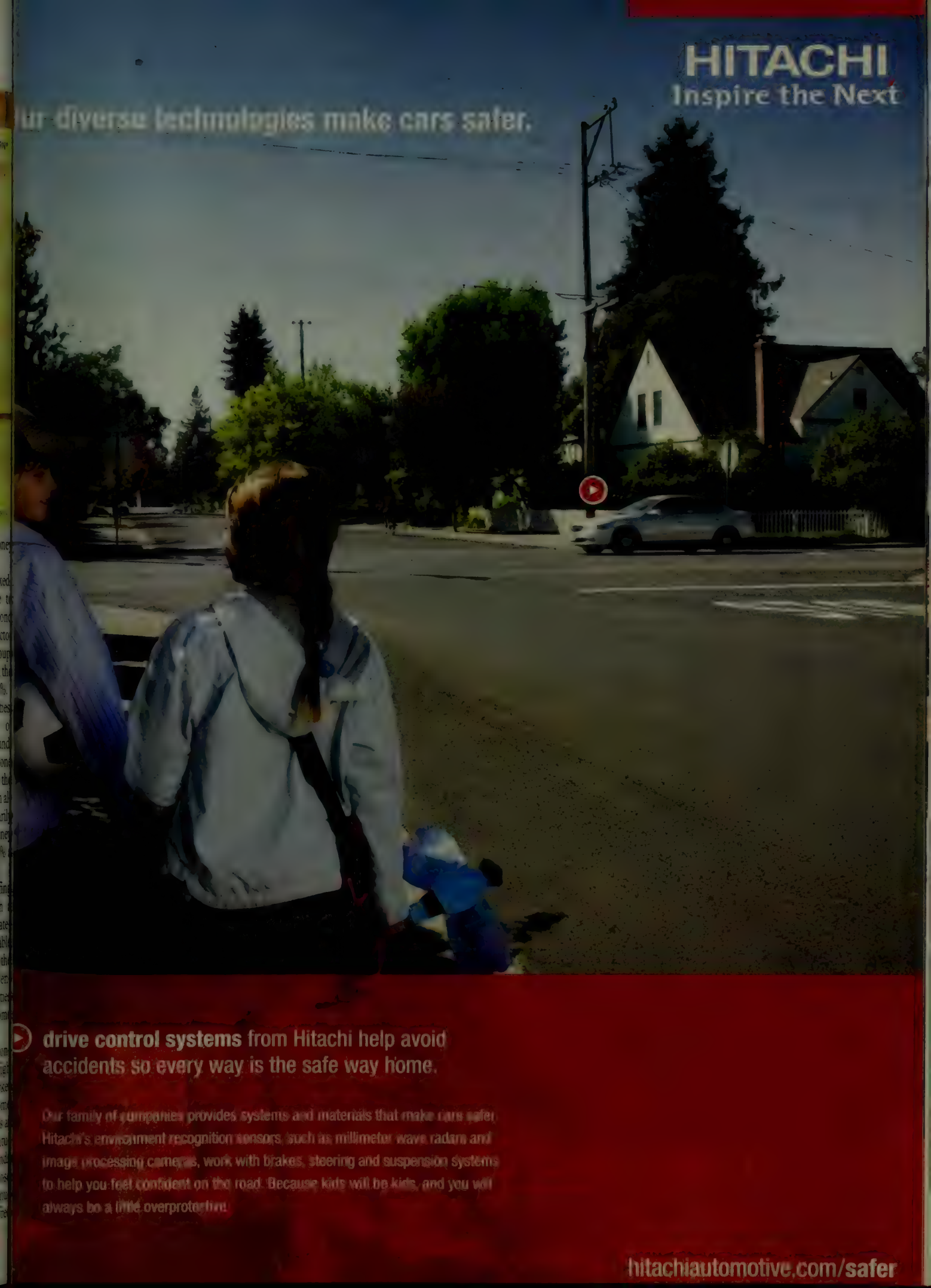
CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
EMERGING MARKETS BOND	10.11%	SHORT (GENERAL)	1.27%
MUNI. HIGH YIELD	5.12	MUNI. CALIF. INTERM.	1.24
CONVERTIBLES	3.82	MUNI. SINGLE-STATE INTERM.	1.24
MUNI. CALIFORNIA LONG	2.94	MUNI. NATIONAL INTERM.	1.17
MUNI. NEW YORK LONG	2.32	SHORT GOVERNMENT	1.11
MUNI. NATIONAL LONG	2.25	INTERMEDIATE GOVERNMENT	1.07
MUNI. SINGLE-STATE LONG	2.17	MUNI. SHORT	1.04
HIGH YIELD	2.11	INTERMEDIATE (GENERAL)	1.01
ULTRASHORT	1.96	INTERNATIONAL BOND	-3.00
LONG GOVERNMENT	1.85		
MUNI. NEW YORK INTERM.	1.50	ALL NON-TAXABLE BOND FUNDS	1.90
LONG (GENERAL)	1.45	ALL BOND FUNDS	1.63
MULTISECTOR	1.44	ALL TAXABLE BOND FUNDS	1.41

*Appreciation plus reinvestment of dividends and capital gains before taxes, Dec. 31, 2004 through Dec. 9, 2005 Data: Standard & Poor's

Equity Funds Outpace the Market

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
LATIN AMERICA	54.02%	COMMUNICATIONS	8.09%
NATURAL RESOURCES	43.03	ALL CAP	8.07
DIVERS. EMERGING MKTS.	29.23	SMALL-CAP GROWTH	7.70
PRECIOUS METALS	25.21	SMALL-CAP BLEND	7.62
JAPAN	24.19	LARGE-CAP GROWTH	7.53
DIVERSIFIED PACIFIC/ASIA	23.41	INTERNATIONAL HYBRID	7.22
PACIFIC/ASIA EX-JAPAN	16.65	TECHNOLOGY	6.85
UTILITIES	15.15	LARGE-CAP VALUE	6.60
FOREIGN	13.36	FINANCIAL	6.09
REAL ESTATE	11.81	LARGE-CAP BLEND	6.00
EUROPE	11.73	MISCELLANEOUS	5.28
MID-CAP GROWTH	10.48	DOMESTIC HYBRID	4.64
WORLD	10.30		
MID-CAP BLEND	10.02	INTERNATIONAL EQUITY FUNDS	15.22
HEALTH	9.67	ALL EQUITY FUNDS	9.01
MID-CAP VALUE	9.43	U.S. DIVERSIFIED FUNDS	7.67
SMALL-CAP VALUE	8.35	S&P 500	5.70

*Appreciation plus reinvestment of dividends and capital gains before taxes Dec. 31, 2004 through Dec. 9, 2005 Data: Standard & Poor's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Mining the Vein Of Great Ideas

Patents can clue smart investors in to the Next Big Thing from innovative companies. BY CHRISTOPHER FARRELL

IN AN INTENSELY COMPETITIVE global economy, the surest path to boosting a company's profit margin and stock price is a steady stream of novel products and inventive services. Think Apple Computer Inc.'s iPod line and Google Inc.'s lightning-fast search engine.

How can investors get in early on corporate innovation before a stock takes off? You could look for companies that spend heavily on research and development. But there is no simple correlation between increased research and development spending and higher stock prices. In fact, stepped-up R&D often depresses near-term earnings because those costs must be expensed now while the payoff of new innovative products could be years away. Besides, much R&D spending produces nothing that customers want.

IDEA FACTORY Using a molecular-beam tool to study new silicon material

MEASURING SUCCESS

THAT'S WHY IN recent years sophisticated investors such as hedge funds and mutual funds have been seeking an edge in the market by looking at R&D through the prism of patents. The U.S. Patent & Trademark Office (USPTO) awards patents to original ideas, granting the creator property rights for the innovation over a long time. In a sense, a patent is a gauge of R&D success. "Patents are an output measure rather than an input measure like R&D," says Patrick Thomas, principal at 1790 Analytics, a consulting firm that studies patents for hedge funds, institutional investors, and the like. (Why 1790? That's when George Washington signed the first U.S. patent, issued to Samuel Hopkins for a new method of manufacturing potash.)

The first trick is for investors to separate out the patent diamonds from the patent zircon. There is a lot of the latter, too, since the USPTO received a record 405,302 patent applications in fiscal 2005, up from 236,679 a decade earlier. Research shows that a key indicator of a genuinely innovative idea is how often a company's existing patents are cited in future patent applications. (To give just one historic example of durable ideas 32% of Thomas Edison's patents granted between 1910 and 1930 were cited in patents awarded from 1976 to 2002, according to Tom Nicholas, an assistan

"Strong buy" should mean "strong buy," not "please buy."

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professor at the Harvard Business School.) This is a key insight behind the patent Pipeline Quality index developed by 1790 Analytics. Other factors that affect the measure are a patent's originality, general applicability to different fields, and the growth trend in a company's patent activity (table).

In any list, it's hardly surprising that technology and biotech figure prominently in generating consequential patents. Yet every industry has its own idea factories. Take Weatherford International. The oil patch company has a strong market position in improving the efficiency of marginal deposits in the U.S. and elsewhere, according to Morningstar. Weatherford has tripled its R&D expenditures and more than doubled its patent activity over the past five years, mostly in advancing oil-field technology. Over the past 60 months, investors have rewarded Weatherford with a total return of 109%, vs. 3% for the Standard & Poor's 500-stock index.

Companies that hit a rocky earnings patch are intriguing. International Game Technology is a formidable innovator in the gaming industry. Yes, its earnings were essentially flat in its fiscal 2005, and the maker of slot machines and other games is down 12% so far this year. But IGT spends more than twice its rivals on R&D, and it has increased by eightfold the number of patents it has issued annually since 2000, according to ipIQ, a New Jersey-based consulting firm that analyzes patents and intellectual property.

The list of innovative companies with high Pipeline Quality includes some old-line industrial companies, too. Deere & Co., the world's premier agricultural equipment maker, got that way through its long R&D tradition. In fact, John Deere, the company's founder, filed his first patent application in 1864.

CLASSIC EXAMPLE

A GOOD GRASP of the quality of a company's patent portfolio is valuable information to investors. But that isn't enough. Companies need marketing, production, and other skills to capitalize on those ideas. A classic example is Sun Microsystems Inc., a highly innovative company with a strong portfolio of intellectual-property rights. Still, because of erratic earnings and revenues, Sun's stock sells at a discount to its major rivals. Another example is Callaway Golf, once in the model portfolio held by consulting firm ipIQ, which aims to identify undervalued companies with quality patent portfolios. "Fabulous technology," says Gerry Komlofske, chief executive officer of ipIQ. "But they didn't have Tiger Woods as a spokesman." The stock has been an underperformer for four years.

Another intriguing indicator of a company's innovative prowess is the money it earns from its patent portfolio through royalty and licensing fees. The practice is largely concentrated among R&D-intensive industries such as chemicals, technology, and pharmaceuticals. For instance, IBM has been awarded more U.S. patents than any other company for the past 12 years in a row (data ending in 2004). A little more than a dozen years ago, the computer giant earned some $300 million annually on its intellectual property. That sum has since swelled to nearly $1.2 billion. A problem for investors, though, is not all companies disclose their royalties as does IBM.

> **Companies need marketing, production, and other skills to capitalize on R&D**

They should. A 2004 research paper by economists Feng Gu of Boston University and Baruch Lev of New York University found for one thing, that investors put a high value on royalty income as a source of persistent, high-quality earnings. "What's more, royalties are like a good housekeeping seal of approval about a company's technological capability," says Lev.

Corporate accounting systems evolved during an era when a company's wealth was measured largely by its real assets such as factories and machinery. Today wealth is created by the impact of new ideas and other intangible assets, like patents. Find a way to assess the value of those patents, and you just might find some winning companies before they come out with a blockbuster product like the iPod. ■

Investing in the Patent Patch

To find innovative but undervalued stocks, look at a company's patents. The companies in this table have much higher-than-average patent portfolios and sell at p-e ratios below their industry peers.

STOCK / SYMBOL	PRICE*	P-E RATIO**	PIPELINE*** QUALITY	SECTOR
KLA-TENCOR KLAC	53.86	25	3.76	Semiconductor equipment
NOVELLUS SYSTEMS NVLS	25.19	29	2.96	Semiconductor equipment
INTL. GAME TECH. IGT	29.70	25	2.94	Gaming equipment
LAM RESEARCH LRCX	39.15	21	2.05	Semiconductor equipment
MICROSOFT MSFT	27.89	24	1.99	Software
CISCO SYSTEMS CSCO	17.69	20	1.87	Networking equipment
SANDISK SNDK	49.32	28	1.82	Memory devices
LYONDELL CHEMICAL LYO	25.13	15	1.73	Diversified chemicals
AMGEN AMGN	81.64	29	1.47	Biotechnology
APPLERA ABI	27.86	22	1.43	Scientific instruments
GARMIN GRMN	26.25	23	1.38	GPS products
BELLSOUTH BLS	27.84	13	1.34	Telecommunications
DEERE DE	69.08	12	1.26	Agricultural equipment
SPRINT NEXTEL S	25.40	21	1.22	Telecommunications
WEATHERFORD INTL. WFT	36.04	15	1.22	Oil-field services

*[illegible] **Based on last 12 months' earnings
***[illegible]ne Quality is a gauge created by 1790 Analytics. It includes the impact of a patent, measured by how frequently patents are cited in later [illegible]ications, general applicability, or how useful the patent is on other fields, the growth trend in a company's patent activity, and originality. The average Pipeline Quality for the whole patent system is 1, and anything higher reflects above average patent performance.

Data: 1790 Analytics, company reports, *BusinessWeek*, Bloomberg Financial Markets

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Sweet Times For Dealmakers

Mergers should accelerate in 2006, with lots of action coming from the financial, energy, and tech industries. BY ROBEN FARZAD

WHILE WORKADAY traders and portfolio managers were struggling to generate returns in 2005, one corner of Wall Street was thriving: mergers and acquisitions. When the books close on the year, U.S. M&A activity likely will have touched $1 trillion, up from $824 billion in 2004, according to Thomson Financial.

Many signs point to an acceleration in deals in 2006. The hottest sectors, according to market watchers: finance, technology, and energy. Plus anywhere cash-rich private-equity funds care to dabble. Naturally, M&A specialists such as Goldman, Sachs & Co. and Morgan Stanley will happily egg on—and profit from—the action as well. "The environment is pretty ripe," says James W. Paulsen, chief investment strategist at Minneapolis-based Wells Capital Management. "You have a rising stock market, tons of corporate cash, and low interest rates," he says.

Financial-services mergers were relatively scarce in 2005. Bank of America's $35 billion acquisition of credit-card outfit MBNA Corp. in June—one of the largest financial-sector deals in recent memory—grabbed headlines, but 2005 will likely turn out to be the second slowest year ever for deals involving banks with at least $500 million in assets. With 27 through early December, 2005 has well below the average of 50 deals a year seen during the 1990s.

STAR CANDIDATE

BUT "THINGS WILL pick up [for financials] in 2006," says Thomas Michaud, chief operating officer for Keefe, Bruyette & Woods Inc., a New York boutique investment bank specializing in the financial-services industry. In particular, regional banks—always a target—have seen an uptick in consolidation that seems likely to extend into the new year. Four of the 15 companies on Keefe Bruyette's June, 2005, takeover list have since been acquired.

Right now, Keefe Bruyette has West Palm Beach (Fla.)-based Fidelity Bank shares high on its roster of buyout candidates. At 32.74, Fidelity's shares trade near their all-time high of 33.21, well off their year low of 22.27. They no doubt have a fair amount of takeover speculation already baked in. But Keefe Bruyette sees Fidelity as the most attractive banking target in the Sunshine State. Its rather high expense-to-income ratio, in particular, makes it ripe for a suitor looking to wring cost savings out of an acquisition. Potential buyers include Winston-Salem (N.C.)-based BB&T, Montgomery (Ala.)-based Colonial Bancgroup, and Greenville (S.C.)-based South Financial Group. Keefe Bruyette sees Fidelity potentially fetching a takeout price of $36 a share.

The technology sector, now nearly six years removed from NASDAQ 5000, is poised to see more capitulation, in which companies grappling with slower growth decide to sell to better-positioned rivals. Case in point: Cisco Systems Inc. recently snapped up cable-television boxmaker Scientific Atlanta.

Nowhere is the trend more apparent than in software, where Oracle Corp. has been a serial acquirer, completing its $10.3 billion takeover of rival PeopleSoft in January and bidding $5.85 billion for Siebel Systems Inc. eight months later. "A software company is like a shark," says John C. Rizzuto, software analyst with Manhattan-based Lazard Capital Markets LLC. "It has to keep moving to survive." Bit players that offer one tool or applica-

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tion need to ask themselves if they can afford to keep going it alone when the Oracles and Microsofts are becoming more entrenched and looking for extra pieces to fit into their sprawling product suites. "It's now about getting a bunch of little things from one vendor," says Rizzuto.

He points to TIBCO Software Inc., an integration software maker in Palo Alto, Calif., with about $500 million in annual revenue, as a company that can't afford to remain independent. "They'll inevitably lose market share as bigger competitors encroach," he says. Other software makers that have bolt-on appeal to larger rivals include BEA Systems, Vitria Technologies, and IONA Technologies, says Rizzuto—all sub-$10 stocks.

IN CANADA
A Suncor field

OIL-FUELED DEALS

THE SAME FORCES are bearing down on hardware makers, says Mark Zanoli, JPMorgan Chase & Co.'s head of tech banking. He views struggling printer maker Lexmark International Inc. as a candidate to sell out to a larger, more diversified vendor. Lexmark's stock has plunged 47% from its high this year because of poor earnings.

The energy sector should see some dealmaking, too. During the late 1990s energy was a classic consolidation-capitulation story, with $15-a-barrel oil prompting an unprecedented wave of megamergers as companies sought to cut costs. Now, with oil at more than $50 a barrel, surging profits and share prices could fuel deals. With supply tight and refining capacity strained, "companies will find it cheaper to buy than develop resources," says Todd S. Lowenstein, co-portfolio manager of the $500 million HighMark Value Momentum Fund.

Lowenstein says Suncor Energy, which operates in Canadian oil-sands fields, is a compelling acquisition candidate. Oil sands are swaths of petrol-rich ground where oil can be extracted, but they're tapped only when crude prices are high enough to make the costly process worthwhile. Suncor makes respectable profits when crude is at $28 a barrel, says Lowenstein. At current prices, the company is "just printing money." There's more than profitability involved, however. "You have no exploration risk," says Lowenstein. "It's a secure resource in a friendly country."

Utilities are primed to continue their long, if fitful, consolidation. The Energy Policy Act of 2005 repealed Depression-era limits on utility cross-ownership and will shrink the number of utilities from 100 to just 10 or 20 over the next decade, says Lowenstein. The big guns agree: In May, Iowa's MidAmerican Energy Holdings Co., which is owned by Warren Buffett's Berkshire Hathaway, announced plans to buy PacifiCorp, an Oregon utility, for $9.4 billion.

The need for almost half a trillion dollars' worth of energy grid upgrades—laid bare for the world to see during the Northeast power blackout of 2003—underscores the importance of scale. A company such as Raleigh (N.C.)-based Progress Energy Inc., with a relatively digestible market capitalization of $11 billion, could soon end up in someone else's arms, says Lowenstein.

The wild card in the M&A game is private equity. According to *Buyouts Magazine*, a record $151 billion of sponsored leveraged buyouts were completed from January through the end of November vs. $137 billion for all of 2004. Nine of the top 10 biggest-ever private equity deals were announced in 2005, according to deal tracker Dealogic. (The largest is still the $25 billion buyout of RJR Nabisco in 1988.)

Record inflows into private-equity funds are giving them plenty of ammunition. Their capital bases are "astonishing," says Terrance Bessey, a Washington D.C.-based partner at law firm Patton Boggs LLP who specializes in private equity. Indeed, according to the private equity practice at Ernst & Young LLP, U.S. fund-raising in the sector has hit $120 billion so far this year, triple the figure for all of 2004. That's making funds more aggressive. In September a private-equity consortium of Clayton, Dubilier & Rice, Carlyle Group, and Merrill Lynch Global Private Equity outbid Blackstone Group, Texas Pacific Group, Bain Capital, and Thomas H. Lee Partners for rental car giant Hertz, which brought $15 billion, including debt, for parent Ford Motor. Grocery chain Albertson's Inc. and newspaper publisher Knight-Ridder Inc. are now weighing bids from suitors.

Analysts expect generous buyout prices to persist as long as low borrowing costs make that possible. John O'Neill, Americas director of private equity for Ernst & Young, foresees private equity purse strings loosening at least through the first half of 2006: "The recipe for deal success has one main ingredient—cash." The recipients of any such largesse, shareholders, are in no hurry to see that feast end. ■

Takeover Candidates?

COMPANY/SYMBOL	PRICE*	P-E RATIO**
FIDELITY BANKSHARES FFFL One of the most attractive banks in the fast-growing Florida market	32.74	22
LEXMARK LXK The printer maker could be fielding bids after a tough year	47.30	16
SUNCOR ENERGY SU High crude prices make this Alberta, Canada, oil-sands specialist attractive to energy giants	63.42	13
TIBCO SOFTWARE TIBX Once a $130 stock, this business infrastructure software maker is ready for a sale	7.48	27

*Dec. 9 **Based on 2006 earnings estimates
Data: Bloomberg Financial Services, I/B/E/S

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After the Housing Runup

Most of the big gains are behind us, but there are still pockets of value. BY PETER COY

CHICAGO Rental properties in inner cities missed the boom

YES, INTEREST RATES ARE rising, and years of double-digit price increases have left big portions of the real estate market extremely expensive. But not everything has gotten out of reach. If you stick to properties that are less vulnerable to rising interest rates and are willing to consider some out-of-fashion cul-de-sacs of the real estate market, you can still find deals that pay an attractive income and have the potential for capital gains.

To make money in real estate in 2006, focus on the sectors that will reap immediate benefits from a strong economy—and be extremely choosy. Real estate investment trusts (REITs) that own hotels or apartments might be good choices because they can raise their rents relatively quickly in a strong economy—as opposed to, say, office building owners, whose tenants are protected by long leases. REITs that benefit from global trade could do well in 2006, as could REITs concentrated in Texas, which has largely missed out on the real estate gold rush.

The first rule for 2006: Don't equate real estate with your own home sweet home. For many people in recent years, "investing in real estate" has meant renovating their houses, trading up to a bigger house, or buying a vacation home (or two). The spending seemed to pay off as prices went up and up. But that was an artifact of a bull market that seems to be pretty much over. In 2006, it will become clear that from a strictly financial viewpoint, investments in the places you live can be a waste of money. The $50,000 you spend on a fancy new kitchen could upgrade your lifestyle, but it may add little value to your home if potential buyers don't like your taste. Ditto for the lovely beachfront cottage you hanker for if it's in a market that's about to fall.

HIT THE HEARTLAND

IF YOUR PRIORITY is investment returns rather than luxurious living, save up the money you would have spent on your own home and put the cash into something less glamorous but more profitable. For example, rental properties in blue-collar neighborhoods of cities in the heartland that have been relatively unaffected by the housing sector's gold fever. As a landlord you have the opportunity to upgrade the property to increase its income-generating poten-

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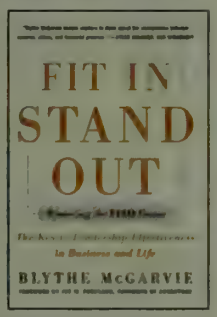

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tial. That's something you can't do when you buy shares of stock. (Unless, of course, you're Carl Icahn or Kirk Kerkorian.) The ideal buy is a dog of a property on an otherwise good street. Says Erin Beitelschees, marketing manager of Recasa, a Columbus (Ohio) lender that specializes in rehabs: "The saying goes: 'If it smells, it smells like money.'"

You have to look harder to find value among REITs—corporations that own properties or mortgages and are required by law to pay out nearly all of their income in dividends. According to an October study by Standard & Poor's, REITs have outperformed ordinary stocks over the past three, five, seven, and 10 years. But their shares are trading at anywhere from 13 to 18 times next year's funds from operations—a measure that's roughly equivalent to pretax earnings in non-real estate companies. Multiples are 30% or 40% above historical averages. "REITs have been very richly priced," says Anthony B. Sanders, a finance professor at Ohio State University's Fisher College of Business and the former head of asset-backed and mortgage-backed securities research at Deutsche Bank in New York. Sanders says some REIT executives have told him privately that they're buying expensive properties just to please Wall Street by showing continued asset growth.

> Hotels stand to gain from a spurt in economic growth: They have the shortest leases of all

So where is there still value? Some apartment REITs stand to do well because higher mortgage rates could force some would-be house buyers to keep renting, says Stephen C. Swett, chief REIT analyst for Wachovia Securities. Also, he says, apartment leases typically run only a year, so landlords can raise the rents quickly to capitalize on strong job and income growth. Swett sees value in Colonial Properties Trust, which operates in the Sunbelt, and United Dominion Realty Trust, whose stock has trailed its peers.

Some hotel REITs should do well, too. Hotels, of course, have the shortest leases of all—often just one night—making their revenue the most sensitive to economic strength. Lately they have been raking in the cash. In New York's Times Square area, luxury hotel chains' average revenue per available room hit $360 in October, up 44% in the past three years, according to Smith Travel Research Inc. of Hendersonville, Tenn. Says Swett's colleague Jeffrey J. Donnelly: "It becomes a name-your-rate business." Some analysts like Strategic Hotel Capital. Hurricane Katrina damaged its Hyatt Regency in New Orleans, which the mayor used as his bunker during the storm, but things are going full blast at its other luxury properties, from the Fairmont in Chicago to Miami's InterContinental.

Stay away from most REITs that own office buildings. They behave like bonds because their tenants have long leases with fixed rentals—meaning that the value of their buildings tends to fall when interest rates rise. And steer clear of the sectors that have been driven by speculation, such as condos in Las Vegas, Miami, Phoenix, and many parts of California.

BUY RETAIL

CONSUMER SPENDING may grow more slowly in 2006 than in 2005, but that's no reason to reject retail REITs outright. Retail spending has grown so briskly that tenants of malls and shopping centers who signed their leases years ago have been getting a huge bargain. With the leases coming up for renewal, owners should be able to raise rents substantially, says Scott T. Crowe, global head of real estate research at UBS. He likes Simon Property Group, an Indianapolis-based giant that operates malls and premium outlets, as well as Kimco Realty, which operates neighborhood and community shopping centers. Some investors like another shopping center REIT that's also a play on Texas real estate—Houston-based Weingarten Realty Investors, which has 40% of its rentable space in Texas.

A good way to play real estate in 2006 is to look for the sectors that will ride the big macroeconomic trends. Global trade is likely to keep expanding in 2006. Morgan Stanley analyst Gregory J. Whyte thinks that will lift ProLogis in Aurora, Colo., which has one-third of a billion feet of distribution space built or under construction—including projects in China. (ProLogis doubles as a play on Texas, where it has big operations.) Another major macro trend is the recovery of the long-suffering Japanese economy. Crowe of UBS thinks that will boost Mitsubishi Estate, a Tokyo developer of office buildings, hotels, and resorts.

Real estate won't be the surefire investment in 2006 that it has been in recent years. But carefully chosen investments still make sense as part of a diversified portfolio. ■

The Cost of Luxury

The *BusinessWeek* Luxury Housing Affordability Index shows big gaps between cities. The higher the index number, the more affordable the market.

CITIES	LUXURY HOUSING PRICES*	AFFORDABILITY INDEX
ATLANTA	$365	192
CHICAGO	530	129
PHOENIX	529	109
WASHINGTON	841	100
BOSTON	879	96
NEW YORK	725	94
MIAMI	695	76
SAN DIEGO	955	68
SAN FRANCISCO	1,576	64
LOS ANGELES	1,000	63

*Third quarter, 2005, in thousands of dollars

Data: Fidelity National Financial Inc., Housing & Urban Development Dept., Federal Housing Finance Board

HOW WE CREATED THE INDEX

The usual affordability index tells whether a mid-market house is within the budget of a middle-income family. *BusinessWeek*'s index looks at high-end homes and upper-income families. An index value of 100 means that given prevailing mortgage rates, a family earning just enough to be in the top 10% of incomes in a metro area should be able to afford a house that is just expensive enough to be in the top 10% of prices.

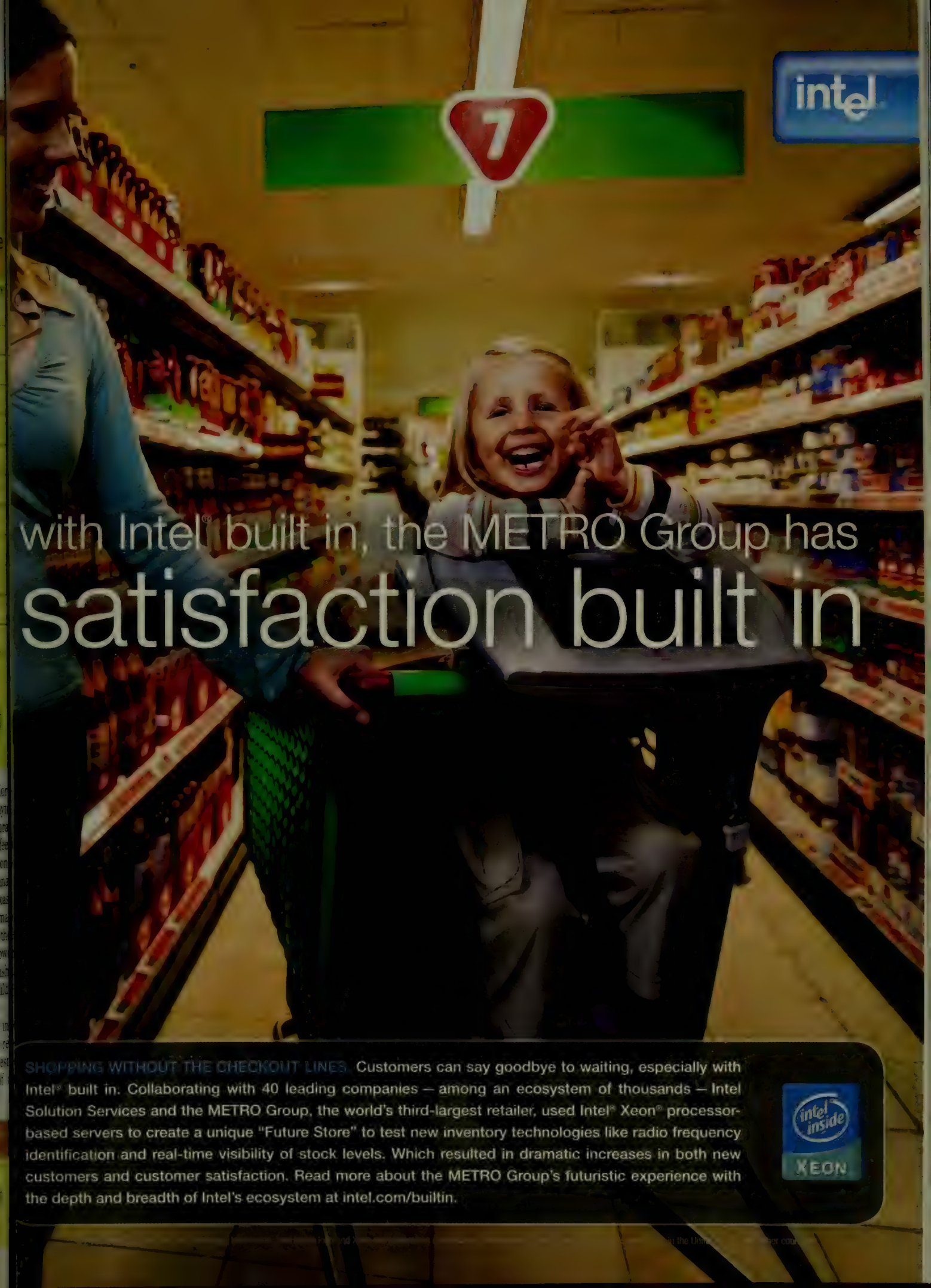
How to Play a Pricey Real Estate Market

DON'T KID YOURSELF that a beach house or a new kitchen is an "investment" when it's really a lifestyle upgrade

LOOK FOR FIXER-UPPERS such as slightly shabby rental properties in otherwise good areas

BET ON GROWTH by investing in sectors such as hotels and apartments that can readily raise rents

LOOK FOR NICHES such as Texas, bypassed by the boom, and distribution facilities, which benefit from trade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Doug Leggate
Director of U.S. Oil & Gas Research, Citigroup

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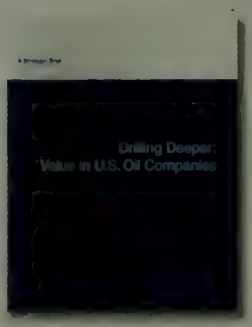

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Hedging Against Inflation

BY JOSEPH WEBER

Think that whiff of inflation in the air may get stronger in the new year? With the effects of the fall's hurricanes receding and energy oil prices dropping, along with continued vigilance by the Fed, most prognosticators don't see a big uptick through 2006. That doesn't mean you should let down your guard on the traditional inflation hedges, such as gold and commodities. After all, a year ago, forecasters underestimated how bad inflation would be in 2005.

Commodities

FORMAT Futures, limited partnerships, mutual funds

WHAT HAPPENED IN 2005 Rapid growth in the developing world, especially China and India, has sharply driven up the prices for copper, platinum, and other metals. The Goldman Sachs Commodities Spot Index was up nearly 42% for the year to date, as of Dec. 9.

OUTLOOK FOR 2006 Double-digit rises are expected to continue. "Investors should have hard assets in their portfolio," says New York planner Kathleen Piaggesi. Natural-resources funds offer the broadest plays, whether they buy commodities contracts or stocks in producers, and allow for a quick exit if prices overshoot demand.

Currencies

FORMAT Cash, futures, mutual funds

WHAT HAPPENED IN 2005 The surprise of the year. Despite higher inflation in the U.S. and record budget and trade deficits, the greenback rose against the euro and the yen. That means the euro is down about 13% against the dollar and the yen 15%. The Chinese government finally relented and revalued the yuan against the dollar, but only by a little bit—about 5%.

OUTLOOK FOR 2006 The dollar is expected to resume its long-term slide, making other currencies, particularly the euro, appealing. The Swiss franc is a good bet if you believe gold prices will climb, since the Swiss hold lots of the metal.

Energy

FORMAT Energy company stocks, limited partnerships, futures

WHAT HAPPENED IN 2005 Oil soared to new heights and then retreated a bit, with commonly watched West Texas Intermediate crude oil climbing from an average of about $47 a barrel in January to an average of $65.59 in September. It has since slipped to about $60 a barrel now, according to the U.S. Government's Energy Information Administration.

OUTLOOK FOR 2006 Similarly sharp short-term climbs seem unlikely, barring supply disruptions. Still, pressure on oil won't abate soon, as demand continues to rise. Global growth will keep driving oil prices, so selected stocks might be worth bets.

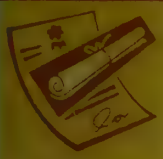
Gold

FORMAT Physical gold, exchange-traded funds, commodity futures

WHAT HAPPENED IN 2005 The precious yellow metal shot up from $428 in January, to $536 an ounce in December amid worries over soaring trade deficits, inflation, energy price hikes, and fears that Social Security would crumble.

OUTLOOK FOR 2006 Skepticism abounds over the sustainability of current prices, the highest in two decades. Given the runup, a pullback is a strong possibility—and some advisers say it may be smart to make purchases if gold falls below $450. Still, don't bank on the $800-an-ounce record set 25 years ago, and keep in mind that prices fell below $300 during the 1990s.

Inflation-Indexed Securities



FORMAT U.S. Treasury Inflation-Indexed Securities, Series I Savings Bonds, mutual funds

WHAT HAPPENED IN 2005 The rise in inflation led to higher returns. Those bonds that reset their rates in the fall got a boost from the Hurricane Katrina-induced spurt of inflation. Ten-year TIPS returned 4.5%, and the I Bonds, 6.73%.

OUTLOOK FOR 2006 With inflation expected to moderate, yields should be lower. The real yield—what you earn over the inflation adjustment—is less than 2%, and that's not expected to change. As inflation moderates, adjustments to I bonds will likely lower the yield. Still, the point of these securities is not to make a killing but to earn a real return on your capital.

Real Estate

FORMAT Residential and commercial properties, real estate investment trusts

WHAT HAPPENED IN 2005 The housing bubble didn't burst, but it's definitely losing air. With prices far outrunning income growth in many markets, what else could you expect? Rising mortgage rates are cutting away at affordability, too, something even creative financing can't paper over.

OUTLOOK FOR 2006 Commercial real estate looks to be a better bet than residential, since businesses will continue to grow and their office needs must be met. One smart way to diversify risk is through real estate operating companies, or REOCs.

ILLUSTRATIONS BY RAY VELLA/BW

The Art of Buying Art

Today's market looks awfully inflated. Tread carefully. BY THANE PETERSON

IN EARLY DECEMBER, SWISS publishing magnate Michael Ringier spent some time at Art Basel Miami Beach, one of the top contemporary art shows. Ringier is a big-time collector, but he didn't buy much. "The opening of the doors was like the beginning of the New York Marathon," he says. "People crowded to get inside first and then fought over pieces. When you saw something you liked, you didn't have to ask. It was sold."

The frenzy in Miami is one of many signs of how red-hot the art market is now. Artprice.com, a French company that tracks world auction results, figures overall prices in New York and London topped their mid-1990 peak for the first time this year—by 33% and 19%, respectively. Meanwhile, Chinese art often soared to four or five times pre-auction estimates at recent Sotheby's and Christie's Hong Kong sales. Indian and Russian works are seeing similar gains.

What's going on? Art has become a trendy alternative investment, and veteran collectors worry the market is getting badly overpriced. "Collectors are being overwhelmed by the speculators," frets Vail (Colo.) collector Kent Logan.

Still, few experts predict a correction anytime soon because demand is far broader than in late 1990, when an end to speculative buying by Japanese collectors caused art prices to collapse. Major collectors continue to pay up for prime pieces: London dealer Giuseppe Eskenazi, acting for a Western buyer, laid out $27.7 million for a tiny, rare 14th century Chinese ceramic jar at a Christie's auction in London on July 12. But most art market veterans would agree with Dallas art economist David Kusin that "there are many reasons to view the next 12 to 18 months with abundant caution." Here are some dos and don'ts for collectors, no matter what you're spending:

Do keep in mind that art is not an efficient investment vehicle.
It's hard to sell fast if you need to raise cash and the world art market is small—only $24 billion in turnover in 2004, Kusin estimates—so speculation distorts prices quickly. Also, studies showing that art appreciates at about the same rate as stocks don't take into account art's high transaction costs, including markups of as much as 50% by private dealers, sales or value-added tax (8.375% in New York, 17.5% in London), and auction house buyer and seller fees that start at about 27% combined. On top of that, you face income or capital-gains taxes if you sell at a profit, as you would on stocks and bonds.

Do set spending limits—and stick to them.
Savvy collectors pay up only for rarities, or to fill out their collection, as when Los Angeles philanthropist Eli Broad anted up $23.8 million for a 1962 steel sculpture by David Smith at Sotheby's on Nov. 11, the highest price ever for a contemporary work. Broad waited 11 years for the piece to come on the market after being outbid on a similar Smith sculpture.

Do your own due diligence so you'll be less vulnerable to fad-buying.
A serious collector like Boston money manager Scott Black can talk endlessly about the history and technique of the Impressionist-era paintings he collects because he spends much of his free time studying books and catalogs and going to shows. Check the bona fides of art advisers carefully; inexperienced ones come out of the woodwork in boom markets.

Don't get involved in buying collectives that plan to flip art at a profit.
Most of the art investment funds launched with such fanfare a few years ago have fizzled, but many small investment groups have formed. Among other

PHOTOGRAPHY
Prints by contemporary photographer such as this one by Martin Parr—will probably appreciate well

PAINTING
Don't overlook museum-quality Old Master works. This painting by Giulio Cesare Procaccini is on sale for $30,000, a relative bargain

SCULPTURE
Philanthropist Eli Broad a record-breaking $23.8 million for this David Sm piece at Sotheby's

weaknesses of the approach, top galleries are clamping down on speculators who flip purchases at auction for big profits. "We're very careful," says London gallery owner Victoria Miro. "We give preference to museums, or to people we know are building serious collections they plan to leave to museums."

Don't get caught up in the emerging-market art frenzy.
Chinese, Russian, and Indian art is soaring on the theory that prices will rise as these nations' economies expand. These markets, however, are getting very pricey, very fast. At Christie's auctions this fall, a piece by Yue Minjun, a 43-year-old Chinese artist, rose to $641,680, more than 10 times what it would have gone for five years ago, while one by Indian Tyeb Mehta, 80, fetched $1.6 million, five times the previous going price for a Mehta painting.

Do consider collecting photos rather than paintings and sculptures.
Prints by photographers such as Edward Weston are setting record prices, and experts believe works by other seminal photographers will appreciate, too. Joshua Holdeman, a senior vice-president with Christie's in New York, considers "any and all" work of the late Garry Winogrand, which starts at about $3,000, underpriced. Others cite the Tennessee-based color photography pioneer William Eggleston ($8,000 and up), Hungary's André Kertész ($3,000 and up), and Britain's Martin Parr ($1,500 and up).

Do consider buying what others won't.
Untrendy but museum-quality Old Master paintings and drawings can often be had for a relative song. New York dealer Robert Simon cites a beautiful oil portrait of an angel's head by the Italian artist Giulio Cesare Procaccini (1574-1625) on sale at his gallery for $30,000.

In general, remember that speculators pay up for pretty paintings that fit easily on a living room wall. Large or controversial works by the same artists sell for far less, as do big, edgy multimedia installations—in which, say, a video plays within an imaginary décor. "You can get a whole [roomful of multimedia art] for $30,000," says Ingvild Goetz from Munich, who has been buying installations for her museum, the Goetz Collection (www.sammlung-goetz.de). And, of course, it may be cheaper to add on to your home, if need be, than to shell out the wild premiums some collectors are paying for art these days. ■

(CLOCKWISE FROM TOP) MARTIN PARR/MAGNUM PHOTOS—COURTESY OF STEPHEN DAITER GALLERY; COURTESY OF SOTHEBY'S; ROBERT SIMON FINE ART

Drilling into the Numbers

Our eight stock screens suit any investment style. BY ROBERT J. ROSENBERG

THE STOCK MARKET CHURNED FOR most of 2005. But investors who bet on the picks in our 2005 Investment Outlook Scoreboard were rewarded nicely. Our eight screens, which searched for everything from fast-growing tech stocks to value plays, returned 11.1% on average from Dec. 31, 2004, through Nov. 30, 2005. That handily beat the Dow Jones industrial average's gain of 2.4%, the Standard & Poor's 500-stock index's 4.9%, and the NASDAQ Composite Index' 3.3%.

As always, we culled the 900 stocks on this year's Scoreboard from the entire universe of publicly held companies, singling out those with annual sales greater than $1.3 billion and share prices of at least $1. Our eight stock screens sift through a vast database of companies based on the main investing styles. For the adventurous, we offer two technology sector searches, one focusing on rising earnings in the coming year and the other based on expectations of long-term earnings growth. Investors seeking the thrill of the new should study our small- and midcap finds as well as our leaders-of-the-pack selections. For more conservative investors, there are two large-company searches, one focusing on above-average long-term growth prospects, the other on dividends and financial stability. And bargain hunters will be drawn to our underappreciated

HARRY CAMPBELL

+3.5 -.6 +1.23.76
+3.5 -.6 +1.23.76
+3.5 -.6 +1.23.76
654 +3.2
+4.23 -.43 +6.0

stocks and low price-to-book screens.

We're always looking for different and better ways to crunch the numbers. One value measurement we're experimenting with is based on earnings before interest, taxes, depreciation, and amortization, or EBITDA, which helps investors analyze companies in capital-intensive industries such as telecommunications and cable television. You can find that screen and others, along with the extended results from our eight main screens, online at businessweek.com.

Large-cap stocks, out of favor for several years, might be poised for a comeback. The S&P Midcap 600 and Small Cap 400 indexes have handily beaten the S&P 500 over the past five years. Patient, conservative investors appreciate the stability of big companies, especially when they pay rising dividends.

A company's dividend yield sometimes increases because the payout goes up. But on occasion, the yield rises because the share price falls. To try to dodge the latter, we tweaked our list by sticking to companies with S&P equity rankings of A– or better, signaling financial strength.

Of course, high yields can be a sign of investor anxiety about a company. Consider ConAgra Foods, which heads our list with a yield of 5.1%. The foodmaker has a new president and chief executive in Gary Rodkin, who is trying to engineer a turnaround. Merrill Lynch & Co. analyst Leonard Teitelbaum, who is neutral on the stock, says ConAgra needs to trim its brands, reduce the number of plants it operates, and perhaps cut its dividend.

FED FEARS

ALSO ON OUR list are Bank of America, First Horizon National, and Washington Mutual. Rising interest rates could be a double whammy for these stocks by hurting the mortgage market, a rich source of profits, while simultaneously increasing the companies' cost of capital. Many economists think the Federal Reserve will stop raising rates in early 2006, but there's a gnawing fear that incoming Chairman Ben Bernanke will push rates higher than necessary to establish his inflation-fighting credentials.

Our other large-cap screen turned up well-known companies expected to post strong earnings growth across a wide swath of industries. Seed and herbicide maker Monsanto announced on Dec. 5 that profits in the coming quarter would be twice its original forecast, thanks to stronger-than-expected revenues. Monsanto is benefiting from the growing demand for foods low in trans fatty acids, which are formed when cooking oil is hydrogenated. Some American snackmakers are switching to Monsanto's Vistive soybean oil, which, when hydrogenated, contains less trans fat.

Hewlett-Packard has been one of th best-performing big caps in 2005 afte new CEO Mark Hurd cut costs and refo cused the Silicon Valley giant. Bea Stearns & Co. analyst Andrew Neff ex pects Hewlett's share price to hit $40 i the coming year, up from around $30 o Dec. 9, as investors, impressed by Hurd assign the company a more generou price-earnings multiple.

Not surprisingly, HP also turned up o our list of technology companies expecte to post strong earnings growth in 2006 It's joined by Symbol Technologies which makes bar code scanners and mobile radio-frequency identification equipment. Retailers are expected to adop

Head of the Pack

Companies whose return on equity and earnings growth beat industry averages

	RETURN ON EQUITY	CHANGE IN EARNINGS 2005-06
TXU TXU	123.5%	60%
NEXTEL PARTNERS NXTP	90.7	30
RITE AID RAD	62.6	175
SEAGATE TECHNOLOGY STX	32.7	31
WALTER INDUSTRIES WLT	29.9	159
GEORGIA GULF GGC	29.4	45
SARA LEE SLE	28.0	37
SCHLUMBERGER SLB	26.0	35
CENTERPOINT ENERGY CNP	25.1	45
AMERADA HESS AHC	17.6	66

Small- & Midcaps to Watc

These companies' profits are forecast tc skyrocket next year

	PRICE CHANGE DEC. 31, 2004-NOV. 30, 2005	CHA EAR 200
HANOVER INSURANCE GROUP THG	–22%	6
JO-ANN STORES JAS	–54	5
MONACO COACH MNC	–28	4
SHAW GROUP SGR	62	44
FAIRCHILD SEMICONDUCTOR INTL. FCS	7	4
TRANSATLANTIC HOLDINGS TRH	13	4
ARCH COAL ACI	117	3
MASSEY ENERGY MEE	9	30
MARKEL MKL	–13	29
CROSSTEX ENERGY XTXI	56	23

Quality Yields

The highest-yielding companies with an S&P Equity Ranking of at least A–

	YIELD	S&P EQUITY RANKING
CONAGRA FOODS CAG	5.1%	A–
OGE ENERGY OGE	5.0	A–
AMEREN AEE	4.8	A–
WASHINGTON MUTUAL WM	4.8	A
FIRST HORIZON NATL. FHN	4.6	A+
ALTRIA GROUP MO	4.4	A+
BANK OF AMERICA BAC	4.4	A–
SOUTHERN SO	4.3	A–
BELLSOUTH BLS	4.3	A–
AGL RESOURCES ATG	4.2	A–

Big Caps to Watch

Profits at these companies are expected take off next year

	PRICE CHANGE DEC. 31, 2004-NOV. 30, 2005	CHA EARI 2005
AGILENT TECHNOLOGIES A	48%	43
MONSANTO MON	32	34
EQUITY OFFICE PPTYS. TRUST EOP	7	27
TRANSOCEAN RIG	51	17
ALLSTATE ALL	8	15
LIBERTY MEDIA L	–30	14
DIRECTV GROUP DTV	–21	12
HEWLETT-PACKARD HPQ	41	12
ADVANCED MICRO DEVICES AMD	19	10
CLEAR CHANNEL OUTDOOR CCO	NA	9

FID tagging en masse as a way of track-ng inventory. Symbol is a supplier of FID systems to Wal-Mart Stores Inc., hich has long favored the technology. eik Reid, an analyst at Robert W. Baird, ates Symbol a strong buy.

BURNING COAL

ECH INVESTORS MAY GET some good deas from our long-term growth list. iotech powerhouse Genentech, one of the est-performers in '05, made the list again is year. The constant worry in all high-iers is that furiously strong earnings rospects are already priced into their hares. But our search turned up other ossibilities such as Corning, which keeps eating analysts' expectations thanks to brisk sales of liquid-crystal displays. Another company with promising growth prospects is Broadcom, a chipmaker whose products are at the forefront of the Wi-Fi revolution and found in devices such as portable DVD players.

Small- and midcap stocks have been among the best-performing asset classes of the past five years. In fact, our selections returned 32.1% in 2005. Thanks to high energy prices, coal producers Arch Coal and Massey Energy are expected to mine even greater profits in 2006. Earnings at both companies are forecast to increase by 300%. Two other companies, Shaw Group and Hanover Insurance Group (formerly known as Allmerica Financial), have been affected by Hurricane Katrina in different ways. Property-casualty insurer Hanover faced claims, while Shaw Group, a heavy-construction and engineering company, was hired by the Federal Emergency Management Agency to pump out the water from flooded New Orleans under a contract that some analysts suggest could ultimately be worth $500 million.

Some tech dynamos such as Broadcom keep topping the analysts' growth expectations

Petroleum-services giants Schlumberger and Amerada-Hess survived our head-of-the-pack screen that searches for superior returns on equity and strong earnings growth. They're expected to extract profits from high-priced petrol for the foreseeable future.

Finally, bargain hunters will want to check our underappreciated stocks and low price-to-book value lists. While it's true that cheap stocks can get cheaper, not all the companies on our lists are damaged goods. Shares of U.S. Steel have been rising in the wake of the bidding war between Germany's ThyssenKrupp and Luxembourg's Arcelor over Dofasco, the Canadian steelmaker. Some say U.S. Steel is worth $100 a share, twice its closing price of $48 on Dec. 9.

Of course, stock screens are only as good as the assumptions that go into them. Earnings growth might not pan out. Dividends could be cut. An unforeseen accounting blowup could derail years of seemingly solid performance. Use our lists merely as starting points for further research. We've done our best to keep you clear of any storm clouds—the rest is up to you. ■

:h: 2006 Earners

nology companies projected to deliver rior earnings in 2006

	PRICE CHANGE DEC. 31, 2004-NOV. 30, 2005	CHANGE IN EARNINGS 2005-06
ENT TECHNOLOGIES A	48%	432%
HILD SEMICONDUCTOR INTL. FCS	7	431
LETT-PACKARD HPQ	41	122
REW ANDW	-20	104
NCED MICRO DEVICES AMD	19	100
ON TECHNOLOGY MU	15	86
BOL TECHNOLOGIES SBL	-34	83
TRONIC DATA SYSTEMS EDS	0	71
ON CHIR	33	70
ONNECTION PCCC	-33	56

Tech: Long-Term Growth

Technology companies expected to deliver better-than-average earnings growth

	PRICE CHANGE DEC. 31, 2004-NOV. 30, 2005	LONG-TERM EARNINGS GROWTH*
GENENTECH DNA	76%	31.5%
UTSTARCOM UTSI	-63	31.0
GOOGLE GOOG	110	30.0
YAHOO! YHOO	7	25.7
BROADCOM BRCM	44	25.0
JABIL CIRCUIT JBL	29	25.0
NETWORK APPLIANCE NTAP	-12	25.0
NEXTEL PARTNERS NXTP	36	23.8
APPLE COMPUTER AAPL	111	21.0
CORNING GLW	72	20.5

*Annualized three-to-five-year estimates

derappreciated Stocks

panies with low price-to-book and e-earnings ratios

	PRICE AS PERCENT OF BOOK VALUE	P-E RATIO
LAND ASH	111.2%	2.1
ED STATES STEEL X	120.3	4.9
CENTURY FINANCIAL NEW	97.1	5.5
SON TULL RT	107.3	6.1
COMMUNITIES WCI	113.4	6.3
ROUP OMG	88.5	8.1
MOTOR F	108.0	8.5
AMERICA FINANCIAL LFG	95.2	8.9
H FINCH NAFC	114.3	9.0
RY AUTOMOTIVE GROUP ABG	104.6	9.3

Low Price-to-Book Stocks

Companies with low price-to-book ratios and an S&P equity ranking of at least A-

	PRICE AS PERCENT OF BOOK VALUE	S&P EQUITY RANKING
TD BANKNORTH BNK	79.7%	A-
MOLSON COORS BREWING TAP	106.1	A
PINNACLE WEST CAPITAL PNW	116.0	A
OLD REPUBLIC INTL. ORI	118.1	A-
CENTURYTEL CTL	122.2	A
MBIA MBI	127.5	A
LAFARGE NORTH AMERICA LAF	128.7	A
CINCINNATI FINANCIAL CINF	129.5	A-
BOB EVANS FARMS BOBE	130.5	A-
RADIAN GROUP RDN	131.3	A

Prices as of Nov. 30. All other data as of Dec. 8
Data: Thomson First Call, Standard & Poor's Compustat

BusinessWeek online

For a podcast interview with Mara der Hovanesian by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

Outlook Scoreboard 2005

The data and projections you need to make informed choices

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P/E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE: 2004 ACTUAL	ESTIMATES FROM ANALYSTS: 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
ALL-INDUSTRY COMPOSITE	**14470.9**	**142**	**8**	**14.5**	**17.3**	**812**	**26**	**1.6**	**17.1**	**2.0**	**1.35**	**7.42**	**5.93**	**7.70**	**12.2**	
CONSUMER STAPLES SECTOR COMPOSITE	7938.0	41	−2	14.9	17.0	2113	25	1.2	11.8	2.0	1.07	2.20	2.63	3.15	13.1	
1 AUTOMOBILES & COMPONENTS																
INDUSTRY GROUP COMPOSITE	**3820.8**	**25**	**−21**	**8.6**	**11.5**	**249**	**22**	**0.4**	**6.1**	**2.5**	**1.91**	**1.15**	**0.92**	**1.80**	**9.4**	
(A) AUTO COMPONENTS																
INDUSTRY COMPOSITE	2313.6	25	−20	8.7	12.0	226	20	0.3	5.1	2.0	1.51	0.84	1.09	1.87	9.1	
American Axle & Mfg. Holdings AXL	1081.6	21	−31	3.5	8.2	107	13	0.3	4.1	1.5	2.82	2.98	1.42	1.92	10.0	B
ArvinMeritor ARM (9)	935.0	13	−41	55.7b	3.8	107	28	0.1	4.5	4.0	3.01	1.85	0.47*	1.51	7.0	B−
Autoliv ALV	3807.1	44	−9	20.0	13.0	157	13	0.6	6.0	1.1	2.93	3.46	3.50	3.91	11.0	NR
BorgWarner BWA	3420.5	60	11	21.5	14.9	210	14	0.8	7.2	1.1	1.07	3.86	4.30	4.97	13.3	B+
Cooper Tire & Rubber CTB	902.0	15	−32	−21.6	−0.6	94	NM	0.4	8.6	NM	2.86	0.37	−0.23	0.50	12.0	B+
Dura Automotive Systems DRRA	48.3	3	−76	−26.7	−1.8	14	NM	0.0	0.7	NM	0.00	0.66	−0.30	0.18	8.0	B−
Goodyear Tire & Rubber GT	3014.9	17	17	19.4	136.4	1019	9	0.2	NA	3.3	0.00	0.63	1.73	1.65	3.0	B−
Hayes Lemmerz International HAYZ (1)	115.5	3	−66	NM	−26.0	21	NM	0.1	2.2	NM	0.00	−1.73	−1.65	−1.28	5.0	NR
Johnson Controls JCI (9)	13372.0	69	9	11.1b	12.5	221	18	0.5	NA	1.5	1.61	3.98	3.90*	5.15	12.0	A+
Lear LEA	1870.0	28	−54	8.5	−37.3	106	NM	0.1	NM	2.5	3.59	5.77	1.00	2.64	11.0	B+
Modine Mfg. MOD (3)	1146.8	33	−1	3.2	12.5	209	17	0.7	8.2	NA	2.10	1.79	2.03	2.33	NA	A−
Sauer-Danfoss SHS	854.5	18	−18	1.5	6.2	193	31	0.6	7.3	NA	2.67	0.70	0.77	1.48	NA	NR
Tenneco TEN	766.2	17	1	NM	19.3	511	28	0.2	3.7	1.1	0.00	0.31	1.55	1.74	10.5	B−
TRW Automotive Holdings TRW	2498.3	25	22	NA	6.7	200	32	0.2	4.2	1.7	0.00	0.29	1.66	1.75	9.0	NR
Visteon VC	872.0	7	−31	NM	NM	NM	NM	0.5	NM	NM	0.00	−12.26	−3.79	−0.37	6.0	NR
(B) AUTOMOBILES																
INDUSTRY COMPOSITE	7588.8	25	−23	8.3	10.3	303	26	0.7	9.8	3.6	2.90	1.92	0.50	1.63	10.1	
Fleetwood Enterprises FLE (4)	644.7	11	−15	NM	NM	660	NM	0.3	NA	NA	0.00	−1.31	0.42	[illegible]	NA	[illegible]
Ford Motor F	15102.4	8	−44	−16.3	13.5	108	8	0.1	NA	1.3	4.92	1.80	1.02	0.71	6.0	B
General Motors GM	12384.6	22	−45	−5.2	−17.4	55	NM	0.1	1.1	NM	9.13	4.95	−4.05	1.22	5.0	[illegible]
Harley-Davidson HDI	14790.9	54	−11	27.6	32.8	517	16	2.7	12.8	1.3	1.19	3.00	3.38	3.68	12.5	A+
Monaco Coach MNC	438.3	15	−28	−4.4	2.3	139	62	0.3	NA	10.5	1.62	1.23	0.12	0.70	12.0	B
Thor Industries THO (7)	2172.0	38	3	39.7b	20.3	339	17	0.8	15.4	1.2	0.52	1.84	2.13*	2.61	15.0	A−
2 CONSUMER DURABLES & APPAREL																
INDUSTRY GROUP COMPOSITE	**4791.9**	**59**	**2**	**18.7**	**18.9**	**264**	**14**	**1.0**	**11.3**	**1.9**	**1.24**	**4.51**	**5.81**	**6.73**	**12.8**	
(A) HOUSEHOLD DURABLES																
INDUSTRY COMPOSITE	4599.3	71	3	23.0	22.6	236	13	0.8	9.1	2.1	1.22	5.88	7.73	9.04	12.8	
American Greetings AM (2)	1721.8	26	3	NM	6.9	131	21	0.9	11.6	1.6	1.22	0.95	1.64	1.80	10.0	B+

FOOTNOTES: *Actual, not estimated data. NA=not available. NM=not meaningful. NR=not ranked. (a) Four-year compound growth rate. (b) Final year of growth rate calculation is 2005. (c) Final year of growth rate calculation is 2004. (d) Pro forma data. Data compiled by Compustat from sources such as statistical services, registration statements, and company reports that Compustat believes to be reliable but are not guaranteed by Compustat or *BusinessWeek* as to correctness or completeness. This material is not an offer to buy or sell any security. Additional data: Thomson First Call.

The Glossary

A quick guide to what is included in these tables

MARKET VALUE: Share price on Nov. 30, 2005, multiplied by the latest available common shares outstanding.

RECENT SHARE PRICE: Price for a single share of a company's most widely traded issue of common stock as of the close of trading Nov. 30, 2005.

PRICE CHANGE: Percentage change in the company's most widely traded common-stock issue since Dec. 31, 2004.

EARNINGS GROWTH: Compound annual growth rate, calculated using the 2000 and 2004 restated diluted earnings per share (unless noted otherwise).

RETURN ON EQUITY: The latest available net income available for shareholders divided by total equity.

PRICE AS PERCENTAGE OF BOOK VALUE: Share price on Nov. 30, 2005, as a percentage of the latest available book value per share, which is the sum of common stock at nominal balance-sheet value, capital surplus, and retained earnings as shown in company accounts divided by the number of shares outstanding.

P-E RATIO: Price-earnings ratio based on the latest available 12 months earnings and Nov. 30, 2005, stock price.

PRICE-SALES RATIO: Based on the latest available 12 months sales and the Nov. 30, 2005, stock price.

PRICE-CASH FLOW RATIO: The Nov. 30, 2005 stock price divided by the latest available 12 months cash flow. Cash flow is equal to income from continuing operations before extraordinary items plus depreciation and amortization.

PRICE-EARNINGS TO GROWTH RATE: The price-earnings ratio based on the 2005 earnings estimate and Nov. 30, 2005, stock price, divided by the long-term earnings growth rate.

DIVIDEND YIELD: Indicated annual dividend as a percent of the Nov. 30, 2005, stock price.

EARNINGS PER SHARE: Diluted earnings per share—net income (including proceeds from certain convertible securities, warrants, and options that are common-stock equivalents, but excluding extraordinary profits or losses) divided by number of common and common-equivalent shares.

EARNINGS PER SHARE ESTIMATES: Analysts' consensus estimates for 2005 and 2006 compiled by Thomson First Call.

LONG-TERM EARNINGS GROWTH: The median estimate by analysts of the annual growth rate of earnings compiled by Thomson First Call. For most companies, this is for the next 3 to 5 years.

S&P EQUITY RANKING: A measure of a company's historical growth of earnings and dividends, using Standard & Poor's computerized scoring system based on the most recent 10 years of earnings per share and dividends.

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Beazer Homes USA BZH (9)	2915.7	70	44	20.8b	17.4	194	12	0.6	10.3	0.8	0.57	5.59	5.87*	10.67	15.0	B+
Black & Decker BDK	6893.5	88	-1	13.6	36.8	440	13	1.1	9.5	1.3	1.28	5.40	6.86	7.51	10.0	B+
Blyth BTH (1)	811.5	20	-33	7.1	16.6	162	10	0.5	6.8	1.1	2.32	2.22	1.71	1.80	11.0	B+
Centex CTX (3)	9177.4	72	21	36.8	25.1	194	8	0.7	NA	0.5	0.22	7.64	9.78	10.80	15.0	A+
Fortune Brands FO	11390.9	78	1	NM	18.6	324	18	1.7	13.0	1.4	1.85	5.23	4.57	5.36	12.0	B
Furniture Brands International FBN	1021.6	20	-20	-6.3	7.1	109	15	0.4	9.0	1.5	3.01	1.66	1.34	1.40	10.0	B+
Harman International Industries HAR (6)	6427.2	95	-23	62.0b	24.4	619	27	2.1	17.1	1.3	0.05	2.27	3.31*	3.95	22.0	B+
Horton (D.R.) DHI (9)	11081.2	35	17	43.1b	27.4	207	8	0.8	7.3	0.5	1.02	3.09	4.62*	5.33	15.0	A+
Hovnanian Enterprises HOV (10)	3073.1	50	1	58.0b	26.2	172	7	0.6	5.8	0.5	0.00	5.35	7.16*	8.39	15.0	B+
KB Home KBH (11)	5824.4	70	34	21.4	27.6	224	8	0.7	7.9	0.5	1.07	5.70	9.34	11.20	15.6	A
La-Z-Boy LZB (4)	690.4	13	-13	-14.2	5.1	137	27	0.3	12.7	2.3	3.29	0.63	0.49	0.88	12.0	A-
Leggett & Platt LEG	4381.4	23	-17	2.4	11.7	169	17	0.8	9.9	1.1	2.73	1.45	1.37	1.60	15.0	B+
Lennar LEN (11)	9106.1	58	2	36.3	24.2	193	8	0.7	7.5	0.5	1.11	5.70	8.10	9.30	15.0	A-
M.D.C. Holdings MDC	3037.0	58	2	31.4	25.6	172	7	0.7	6.1	0.4	1.47	8.79	10.69	12.25	15.0	A+
Maytag MYG	1425.4	18	-16	NM	NM	NM	NM	0.3	9.8	33.9	2.02	-0.12	0.07	0.17	7.5	B
Meritage Homes MTH	1818.2	56	18	33.9	27.0	239	8	0.7	8.2	0.7	0.00	5.03	9.14	11.58	10.0	B
Mohawk Industries MHK	5884.9	65	-4	16.2	12.7	200	16	0.9	11.8	1.2	0.00	5.46	5.56	6.69	13.0	B+
Newell Rubbermaid NWL	6332.7	23	-5	NM	21.3	368	17	1.0	10.7	2.0	3.64	-0.07	1.46	1.52	8.0	B
NVR NVR	4289.1	687	-11	45.1	70.0	474	9	0.9	6.7	0.6	0.00	66.42	87.40	100.75	12.5	B+
Pulte Homes PHM	10761.4	42	31	31.2	24.3	197	8	0.8	7.8	0.6	0.38	3.84	5.43	6.16	13.0	A
Ryland Group RYL	3338.0	72	24	44.0	31.5	267	9	0.7	7.7	0.6	0.34	6.36	8.90	10.10	13.0	B+
Snap-on SNA	2164.6	37	9	-9.6	8.6	209	24	0.9	15.2	2.1	2.68	1.40	1.50	1.82	12.0	B
Standard Pacific SPF	2565.5	38	18	27.9	26.2	158	5	0.7	6.0	0.5	0.42	4.54	6.02	6.78	13.0	NR
Stanley Works SWK	4013.3	48	-2	9.7	19.9	291	15	1.2	10.8	1.3	2.42	2.85	3.32	3.60	11.5	B+
Technical Olympic USA TOA	1234.2	21	2	21.3	21.4	138	5	0.5	6.0	0.5	0.29	2.08	3.52	4.33	13.0	NR
Toll Brothers TOL (10)	5375.5	34	0	36.4b	29.2	195	7	0.9	7.7	0.5	0.00	2.52	4.78*	5.25	15.0	B+
WCI Communities WCI	1139.1	26	-13	3.9	19.0	113	6	0.5	5.5	0.4	0.00	2.62	4.11	4.89	15.0	NR
Whirlpool WHR	5484.0	82	15	3.2	20.8	290	14	0.4	6.6	2.1	2.10	5.90	6.04	6.34	6.5	B
(B) LEISURE EQUIPMENT & PRODUCTS																
INDUSTRY COMPOSITE	4626.1	30	-17	0.8	6.3	317	16	0.9	9.5	1.9	2.13	1.68	1.98	2.34	10.4	
Brunswick BC	3813.2	39	-21	5.0	17.9	191	11	0.7	7.4	0.9	1.53	2.77	3.23	3.88	13.0	B
Eastman Kodak EK	6879.4	24	-26	-50.1	-59.1	295	NM	0.5	NM	4.3	2.09	0.28	1.11	1.76	5.0	B-
Hasbro HAS	3645.5	20	5	NM	12.0	218	20	1.2	9.6	1.7	1.76	0.96	1.18	1.28	10.0	B
Mattel MAT	6724.9	17	-15	35.5	18.5	295	16	1.3	11.3	1.5	3.00	1.35	1.10	1.13	10.0	B+
Polaris Industries PII	2067.3	49	-27	12.6	42.1	588	15	1.1	9.8	1.1	2.27	3.04	3.27	3.63	14.0	A-
(C) TEXTILES, APPAREL & LUXURY GOODS																
INDUSTRY COMPOSITE	5326.3	42	7	15.5	15.6	309	18	1.4	17.4	1.2	0.91	2.38	2.76	2.98	13.8	
Brown Shoe BWS (1)	757.7	41	38	3.7	8.6	181	21	0.3	NA	1.1	0.97	2.30	3.08	3.34	12.0	B
Coach COH (6)	13102.0	34	22	51.5b	35.5	1123	32	7.2	27.8	1.7	0.00	0.68	1.00*	1.22	20.0	NR
Jones Apparel Group JNY	3364.9	29	-21	-0.9	9.5	127	14	0.7	9.5	1.2	1.67	2.39	2.40	2.57	10.0	B+
Kellwood KWD (1)	643.8	23	-33	-0.7	-7.0	99	NM	0.3	61.3	1.4	2.77	2.50	1.61	1.75	10.0	B+
Liz Claiborne LIZ	3749.6	35	-17	13.5	16.1	187	12	0.8	8.4	1.0	0.65	2.85	2.92	3.04	11.5	A
Nike NKE (5)	22212.1	85	-6	20.0	22.1	372	17	1.6	13.9	1.2	1.45	4.48	5.22	5.76	13.5	A
Phillips-Van Heusen PVH (1)	1419.8	34	26	0.9	12.3	252	19	0.8	9.9	1.1	0.44	1.14	1.90	2.12	16.5	B
Polo Ralph Lauren RL (3)	5618.5	54	26	33.3	13.5	299	22	1.6	15.3	1.4	0.37	1.83	2.93	3.32	13.5	NR
Reebok International RBK	3447.6	56	31	21.5	16.8	236	15	0.9	11.9	1.1	0.52	3.05	3.67	3.42	14.0	B
Timberland TBL	2187.3	33	5	10.6	30.9	415	14	1.4	11.6	1.1	0.00	2.14	2.37	2.48	12.5	B
VF VFC	6281.8	57	2	16.8	19.1	230	12	1.0	9.7	1.4	2.05	4.21	4.64	5.09	9.0	A-
Warnaco Group WRNC	1131.3	25	14	NM	9.6	183	19	0.7	12.1	0.8	0.00	1.02	1.38	1.69	22.5	NR
3 CONSUMER SERVICES																
INDUSTRY GROUP COMPOSITE	**9379.5**	**38**	**1**	**14.2**	**19.6**	**418**	**26**	**1.8**	**12.9**	**1.6**	**1.20**	**1.52**	**1.89**	**2.12**	**14.1**	
(A) HOTELS RESTAURANTS & LEISURE																
INDUSTRY COMPOSITE	10525.7	40	3	9.3	17.0	373	27	1.7	12.7	1.5	1.19	1.57	2.00	2.20	14.0	
Bob Evans Farms BOBE (4)	856.5	24	-8	-7.8	4.9	131	27	0.6	8.5	2.4	1.99	1.04	1.01	1.23	10.0	A-
Boyd Gaming BYD	4315.3	48	16	8.9	17.1	399	23	2.0	12.1	1.2	1.03	1.42	2.38	2.69	17.5	B
Brinker International EAT (6)	3414.0	40	13	5.2b	18.5	342	20	0.9	9.1	1.6	1.01	1.48	1.73*	2.14	14.7	B+
Carnival CCL (11)	34764.6	54	-5	8.8	12.9	203	21	3.2	11.3	1.3	1.84	2.24	2.70	3.13	15.0	A+
CBRL Group CBRL (7)	1729.4	37	-12	30.3b	13.7	193	15	0.7	9.1	1.3	1.41	2.12	2.45*	2.38	12.0	B+
CKE Restaurants CKR (1)	750.7	13	-13	NM	30.6	513	18	0.5	6.7	0.9	1.27	0.31	0.89	0.90	16.5	C
Darden Restaurants DRI (5)	5385.7	36	29	14.4	24.2	427	19	1.0	10.4	1.5	1.12	1.78	2.01	2.25	12.0	A
Domino's Pizza DPZ	1668.4	25	40	NA	NM	NM	17	1.1	NA	1.7	1.60	1.12	1.43	1.57	10.5	NR
Harrah's Entertainment HET	12513.1	68	2	NM	6.8	212	23	2.0	14.3	1.3	2.13	2.92	3.47	3.88	15.0	B
Hilton Hotels HLT	8361.5	22	-4	-4.8	15.5	308	21	1.9	11.4	1.8	0.73	0.60	0.84	1.03	15.0	B
International Game Technology IGT (9)	10076.3	29	-15	14.4b	22.9	529	24	4.2	15.3	1.6	1.70	1.17	1.20*	1.19	15.0	B+
Jack in the Box JBX (9)	1193.6	34	-9	4.9b	16.2	211	14	0.5	6.8	1.4	0.00	2.02	2.48*	2.55	10.0	B

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Marriott International MAR	13462.8	65	8	6.4	18.7	408	24	1.2	16.9	1.4	0.65	2.47	3.11	3.17	15.0	B+
McDonald's MCD	42600.2	34	6	5.2	16.5	293	18	2.1	11.7	2.0	1.98	1.79	2.03	2.16	8.3	A
MGM Mirage MGM	10961.3	38	5	23.5	13.0	338	27	1.9	11.6	1.4	0.00	1.21	1.60	1.94	17.0	B
Outback Steakhouse OSI	3006.5	40	-12	5.7	13.5	256	19	0.9	10.7	1.2	1.29	2.01	2.24	2.58	15.0	B+
Royal Caribbean Cruises RCL	9597.9	46	-16	-0.5	11.5	172	16	2.0	9.2	1.1	1.50	2.26	2.78	2.94	15.0	A-
Starbucks SBUX (9)	23368.6	30	-2	28.3b	23.7	1118	50	3.7	28.0	2.3	0.00	0.47	0.61*	0.66	22.0	B+
Starwood Hotels & Resorts Worldwide HOT	13266.0	61	4	34.3a	6.9	244	36	2.2	16.9	1.8	1.39	1.72	2.28	2.47	15.0	NR
Wendy's International WEN	5891.4	51	29	-25.2	2.7	297	118	1.6	24.1	2.0	1.34	0.45	2.14	2.37	12.0	A-
YUM! Brands YUM	13856.4	49	3	14.9	49.8	866	18	1.5	11.0	1.6	0.94	2.42	2.64	2.68	11.6	NR
(B) DIVERSIFIED CONSUMER SERVICES																
INDUSTRY COMPOSITE	5367.9	32	-6	31.8	28.2	568	24	2.1	13.3	1.7	1.23	1.34	1.49	1.86	14.3	
Apollo Group APOL (8)	12791.9	71	-12	41.3b	62.9	1810	30	5.7	25.0	1.4	0.00	0.77	2.39*	2.91	22.0	B+
Block (H&R) HRB (4)	8043.5	24	0	25.8	39.2	506	13	1.7	9.2	1.2	2.05	1.88	1.92	2.24	10.5	A-
Career Education CECO	3654.5	37	-7	60.1	24.2	380	17	1.8	11.9	0.8	0.00	1.71	2.29	2.54	20.0	NR
Regis RGS (6)	1808.0	40	-13	2.9b	7.8	230	30	0.8	11.4	2.2	0.40	2.26	1.39*	2.42	13.0	A-
Service Corp. International SCI	2447.8	[illegible]	10	NA	3.1	153	43	1.4	NA	2.9	1.22	0.36	0.29	0.34	10.0	B-
ServiceMaster SVM	3461.9	12	-14	29.0	32.3	329	11	0.9	8.8	1.7	3.69	1.08	0.65	0.72	10.5	A
4 MEDIA																
INDUSTRY GROUP COMPOSITE	**15065.4**	**53**	**-15**	**10.0**	**18.0**	**1059**	**55**	**1.8**	**14.6**	**2.6**	**1.26**	**1.45**	**1.99**	**2.52**	**13.3**	
ADVO AD (9)	856.9	27	-23	-6.3b	21.6	462	21	0.6	10.9	1.4	1.61	1.59	1.27*	1.63	15.0	B+
Belo BLC	2416.0	22	-17	-3.3	8.9	152	18	1.6	10.2	4.4	1.83	1.13	1.11	1.32	4.5	B
Cablevision Systems CVC	6827.7	24	-5	NM	NM	NM	NM	1.4	11.3	NM	0.00	-2.32	-0.62	0.22	11.3	C
Charter Communications CHTR	414.9	[illegible]	-47	NM	NM	NM	NM	0.1	0.7	NM	0.00	-11.92	-3.62	-3.32	7.2	NR
Clear Channel Communications CCU	17599.5	33	-3	25.4	7.8	200	26	1.9	12.7	2.1	2.30	1.41	1.22	1.44	13.0	B-
Clear Channel Outdoor Holdings CCO	7105.0	20	NA	NA	28.0	8042	290	2.7	17.1	NA	0.00	NA	0.22	0.42	NA	NR
Comcast CMCSA	57078.3	26	-21	-31.6	3.0	139	49	2.6	11.8	2.7	0.00	0.43	0.59	0.95	16.8	B-
Dex Media DEX	4096.1	27	[illegible]	NA	6.8	591	91	2.5	9.3	13.3	1.32	-0.39	0.41	0.72	5.0	NR
DIRECTV Group DTV	18334.2	13	-21	NM	-1.4	236	NM	1.4	22.7	2.5	0.00	-0.77	0.17	0.39	30.5	C
Disney (Walt) DIS (9)	50039.5	25	-10	83.2b	9.8	191	20	1.6	12.8	1.7	1.08	1.12	1.24*	1.41	12.0	B
Dow Jones DJ	2834.4	34	-21	NM	39.3	2031	52	1.6	17.6	3.0	2.93	1.21	0.92	1.20	12.5	B
EchoStar Communications DISH	11672.5	26	-22	NM	NM	NM	[illegible]	1.4	5.4	0.3	0.00	0.46	3.22	2.08	29.0	B-
Gannett GCI	14861.6	62	-25	7.9	16.4	196	12	2.0	9.8	1.4	1.88	4.92	4.97	5.41	9.0	A
Interpublic Group IPG	4012.5	9	-30	NM	-7.7	359	27	0.6	52.9	NM	0.00	-1.36	-0.38	0.14	10.0	C
Knight-Ridder KRI	4078.0	60	-10	4.0	22.8	334	16	1.4	NA	2.2	2.45	4.13	3.51	3.71	8.0	A-
Liberty Global LBTYA	10677.3	22	-52	NA	-3.7	136	NM	2.3	10.3	NM	0.00	-0.20	-0.49	0.06	15.0	NR
Liberty Media L	21523.1	[illegible]	-30	-44.4	0.2	113	384	2.7	NA	2.9	0.00	0.06	0.05	0.12	49.6	C
McGraw-Hill MHP	19888.4	53	16	13.3	26.7	629	24	3.4	20.1	2	1.24	1.96	††	††	††	NR
†† Since *BusinessWeek* is owned by the McGraw-Hill Companies, the Scoreboard does not include forecasts of the company's earnings																
New York Times NYT	3991.3	28	-33	-3.4	20.3	266	13	1.2	8.9	2.1	2.40	1.96	1.56	1.59	8.6	A-
Omnicom Group OMC	15247.0	85	[illegible]	10.4	20.2	397	20	1.5	16.8	1.6	1.18	3.88	4.38	4.91	12.3	A+
Reader's Digest Association RDA (6)	1530.1	16	12	NM	-20.1	488	NM	0.6	NM	NM	2.58	0.49	-0.95*	0.93	10.0	B-
Regal Entertainment Group RGC	2980.2	20	-3	25.2a	253.0	9284	38	1.2	10.9	3.6	5.93	0.55	0.70	0.99	8.0	NR
Scholastic SCHL (5)	1379.5	33	-10	13.9	10.1	149	14	0.6	8.7	1.2	0.00	1.58	2.43	2.06	11.0	B
Scripps (E.W.) SSP	7587.3	46	-4	15.6	13.6	329	24	3.1	18.9	2.1	0.95	1.84	1.86	2.13	12.0	A-
Time Warner TWX	84096.0	18	-8	19.8	4.2	133	32	2.0	9.5	1.9	1.11	0.68	0.77	0.89	12.0	B-
Tribune TRB	9892.7	32	-24	14.8	9.3	149	16	1.7	11.4	2.5	2.25	1.72	2.13	2.17	6.0	B+
Univision Communications UVN	9339.8	30	3	10.1	4.4	181	47	4.9	29.0	1.9	0.00	0.72	0.83	1.05	19.5	B
Viacom VIA.B	51850.2	33	-8	NM	-37.2	128	NM	2.2	NM	1.5	0.84	-8.78	1.74	1.99	13.2	B-
Warner Music Group WMG (9)	2679.6	18	NA	NA	NM	3011	NM	0.8	NA	NM	2.88	NA	-1.40*	0.16	4.0	NR
Washington Post WPO	7073.7	737	-25	24.7	12.5	279	22	2.0	14.0	2.5	1.00	34.59	29.62	36.19	10.0	B+
5 RETAILING																
INDUSTRY GROUP COMPOSITE	**7661.6**	**32**	**5**	**15.9**	**16.1**	**4587**	**23**	**1.0**	**11.8**	**1.9**	**0.62**	**1.62**	**1.73**	**2.00**	**13.8**	
(A) DISTRIBUTORS																
INDUSTRY COMPOSITE	4085.5	27	1	0.6	50.1	337	10	0.5	10.0	3.0	1.41	3.99	1.99	2.03	6.0	
Genuine Parts GPC	7688.8	44	1	0.6	16.0	290	18	0.8	15.7	3.0	2.82	2.25	2.47	2.68	6.0	A
Jorgensen (Earle M.) JOR (3)	482.3	10	NA	NM	84.1	385	2	0.3	4.3	NA	0.00	5.73	1.52	1.38	NA	NR
(B) INTERNET & CATALOG RETAIL																
INDUSTRY COMPOSITE	19720.1	33	-16	43.2	8.0	67109	36	4.6	25.7	2.1	0.00	0.91	1.04	1.26	17.6	
Amazon.com AMZN	20062.4	48	9	NM	NM	NM	43	2.5	34.2	3.7	0.00	1.39	0.59	0.95	22.0	B-
eBay EBAY	59983.0	45	-23	88.7	12.6	747	61	14.4	44.8	1.9	0.00	0.57	0.84	1.02	27.5	NR
Expedia EXPE	8529.0	25	NA	NA	4.3	148	35	4.1	NA	2.6	0.00	NA	1.21	1.30	8.0	NR
IAC/InterActiveCorp IACI	9037.1	[illegible]	-50	NM	4.3	95	24	1.7	11.3	1.4	0.00	0.46	1.26	1.49	15.5	B-
Insight Enterprises NSIT	989.0	21	2	-2.3	10.9	178	17	0.3	12.5	1.1	0.00	1.22	1.30	1.53	15.0	B
(C) MULTILINE RETAIL																
INDUSTRY COMPOSITE	10015.0	[illegible]	7	11.0	12.9	237	20	0.7	10.2	2.7	0.58	2.22	2.12	2.46	12.0	
Big Lots BLI (1)	1395.8	12	1	-25.4	3.1	132	42	0.3	9.6	3.5	0.00	0.27	0.24	0.46	15.0	B-
Dillard's DDS (1)	1656.1	21	-22	0.9	5.9	74	13	0.2	[illegible]	3.5	0.76	1.41	1.11	1.13	5.5	B+
Dollar General DG (1)	5987.5	19	-9	51.0	21.0	371	18	0.7	11.6	1.1	0.95	1.04	1.15	1.31	15.0	A+

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Dollar Tree Stores DLTR (1)	2490.4	23	-20	10.0	15.8	230	15	0.8	8.1	1.0	0.00	1.58	1.57	1.79	14.0	B+
Family Dollar Stores FDO (8)	3720.1	23	-28	4.7b	15.2	260	17	0.6	11.2	1.5	1.69	1.50	1.30*	1.35	11.5	A+
Federated Department Stores FD (1)	17538.9	64	11	-0.7	8.8	135	11	1.0	8.8	1.3	1.55	3.86	4.72	5.01	10.5	[illegible]
Fred's FRED (1)	661.5	17	-5	13.4	8.1	200	24	0.4	11.8	1.4	0.48	0.71	0.74	0.86	16.0	A
Kohl's KSS (1)	15851.1	46	-6	18.1	14.2	285	20	1.2	14.3	1.0	0.00	2.12	2.46	2.92	18.0	B+
Nordstrom JWN (1)	9946.2	37	58	37.3	25.7	510	21	1.3	12.8	1.6	0.92	1.39	1.93	2.18	12.3	B+
Penney (J.C.) JCP (1)	12173.0	52	27	NM	25.0	356	17	0.7	9.9	1.0	0.95	2.23	3.53	4.17	15.0	B-
Saks SKS (1)	2345.5	17	14	-6.1	5.6	108	19	0.4	7.0	5.2	0.00	0.42	0.40	0.58	8.0	B-
Sears Holdings SHLD (1)	18532.7	115	16	NM	10.6	169	23	0.5	14.4	1.9	0.00	11.00	6.22	7.88	10.0	NR
ShopKo Stores SKO (1)	865.5	29	54	NM	5.2	133	23	0.3	7.5	11.8	0.00	1.46	1.62	1.73	1.5	B
Target TGT (1)	47045.1	54	3	18.2	16.8	347	21	0.9	12.8	1.3	0.75	2.07	2.68	3.09	15.0	A+
(D) SPECIALTY RETAIL																
INDUSTRY COMPOSITE	6151.4	30	5	16.2	16.3	321	23	0.8	11.3	1.7	0.65	1.43	1.69	1.95	14.1	
Abercrombie & Fitch ANF (1)	5439.6	61	31	10.3	32.7	651	20	2.2	15.2	1.0	1.14	2.28	3.48	4.10	17.0	B+
Advance Auto Parts AAP	4615.6	42	45	69.7	24.9	506	21	1.1	13.5	1.1	0.00	1.66	2.13	2.50	17.5	NR
American Eagle Outfitters AEOS (1)	3534.7	23	-3	24.0	27.4	330	12	1.6	9.6	0.8	1.32	1.49	1.88	2.02	14.5	[illegible]
AnnTaylor Stores ANN (1)	2193.0	30	41	3.4	4.2	218	52	1.1	19.4	1.7	0.00	0.88	1.21	1.59	15.0	B
Asbury Automotive Group ABG	549.6	17	22	NA	11.3	105	9	0.1	7.0	1.0	0.00	1.61	1.77	1.87	9.5	NR
AutoNation AN	5416.2	21	5	13.3	9.4	118	13	0.3	10.5	1.2	0.00	1.45	1.51	1.65	11.0	[illegible]
AutoZone AZO (8)	6816.6	89	-2	46.9b	NA	1743	12	1.2	9.6	1.0	0.00	6.56	7.18*	7.65	13.0	B+
Barnes & Noble BKS (1)	2636.0	40	25	NM	14.0	272	22	0.5	8.5	1.4	1.49	1.68	2.04	2.25	14.0	[illegible]
Bed Bath & Beyond BBBY (2)	12646.2	43	7	29.3	21.8	507	24	2.3	19.6	1.2	0.00	1.65	1.91	2.19	19.0	A-
Best Buy BBY (2)	23755.5	48	22	22.0	21.3	493	24	0.8	15.8	1.3	0.66	1.86	2.17	2.56	16.5	B+
Blockbuster BBI	689.3	4	-61	NM	NM	148	NM	0.1	1.4	NM	0.00	-6.89	-0.40	0.21	7.5	NR
Borders Group BGP (1)	1386.6	20	-20	19.5	11.7	155	15	0.4	5.9	1.1	1.77	1.69	1.39	1.61	13.0	[illegible]
Burlington Coat Factory BCF (5)	1774.8	40	75	NA	11.8	195	17	0.5	11.3	1.5	0.10	2.37	2.63	2.98	10.0	B+
Cabela's CAB	1125.9	17	-23	11.8	11.5	189	17	0.7	11.3	1.1	0.00	1.03	1.04	1.19	15.0	NR
CarMax KMX (2)	2869.4	27	-12	24.9	14.5	323	23	0.5	18.8	1.3	0.00	1.07	1.27	1.47	16.0	B-
Charming Shoppes CHRS (1)	1420.7	12	25	2.0	10.8	180	18	0.6	NA	1.0	0.00	0.52	0.75	0.86	15.0	B-
Circuit City Stores CC (2)	3819.1	21	34	-6.8	3.4	200	62	0.4	NA	2.7	0.33	0.31	0.65	0.86	12.0	B-
CSK Auto CAO (1)	678.6	16	-7	NM	13.3	319	24	0.4	11.3	1.4	0.00	0.80	0.92	1.13	12.5	NR
Dick's Sporting Goods DKS (1)	1760.8	35	0	11.5	17.2	493	31	0.7	15.8	1.0	0.00	1.30	1.73	1.80	20.0	NR
Foot Locker FL (1)	3422.8	22	-19	20.8	13.2	176	13	0.6	8.0	1.0	1.65	1.64	1.64	1.82	13.5	B-
GameStop GME (1)	2432.4	34	50	NM	4.9	239	37	1.1	24.1	1.2	0.00	1.05	1.69	1.72	17.0	NR
Gap GPS (1)	15159.8	17	-18	6.0	21.4	281	14	0.9	8.7	1.3	1.04	1.21	1.15	1.30	12.0	A
Group 1 Automotive GPI	754.0	31	-2	-11.0	10.4	120	11	0.1	8.9	1.1	0.00	1.18	2.77	3.11	10.5	NR
Guitar Center GTRC	1370.8	53	0	22.7	19.1	372	21	0.8	14.2	1.1	0.00	2.29	2.73	3.17	18.0	NR
Home Depot HD (1)	88740.7	42	-2	19.7	21.7	344	16	1.1	12.5	1.2	0.96	2.26	2.66	3.03	13.0	A+
Jo-Ann Stores JAS (1)	289.5	13	-54	NM	6.6	70	11	0.2	4.2	14.8	0.00	2.02	0.09	0.57	10.0	B-
Limited Brands LTD (1)	8900.0	22	-3	12.7	24.0	422	19	0.9	10.7	1.6	2.70	1.47	1.29	1.50	11.0	B+
Linens 'n Things LIN	1161.9	26	3	-3.6	4.4	144	33	0.4	9.5	3.4	0.00	1.32	0.63	0.88	12.0	B
Lithia Motors LAD	550.5	29	5	5.7	11.2	122	12	0.2	8.5	1.1	1.68	2.12	2.38	2.56	11.0	B+
Lowe's LOW (1)	52634.4	67	17	27.7	19.0	387	21	1.3	14.7	1.2	0.36	2.71	3.39	3.96	17.0	A+
Men's Wearhouse MW (1)	1579.0	29	38	-0.6	16.3	268	17	0.9	10.6	1.1	0.00	1.29	1.86	2.16	15.0	B+
Michaels Stores MIK (1)	5041.6	37	25	25.2	17.7	378	22	1.4	15.2	1.1	1.07	1.45	1.86	2.19	18.0	[illegible]
Office Depot ODP	9135.3	30	71	60.4	7.5	310	42	0.7	NA	1.5	0.00	1.06	1.37	1.59	14.0	B+
OfficeMax OMX	2064.3	29	-7	-3.1	1.3	119	122	0.2	10.3	8.9	2.06	2.44	0.33	1.06	10.0	B-
O'Reilly Automotive ORLY	3412.8	30	35	20.5	13.4	311	24	1.7	16.5	1.2	0.00	1.06	1.35	1.59	18.5	B+
Pantry PTRY (9)	899.9	41	37	NM	22.9	357	16	0.2	7.4	1.2	0.00	0.76	2.64*	2.78	13.5	NR
Payless ShoeSource PSS (1)	1558.9	23	86	-26.4	9.0	233	26	0.6	10.3	2.1	0.00	0.52	1.16	1.26	9.5	B-
Pep Boys-Manny, Moe & Jack PBY (1)	808.6	14	-16	NM	-3.7	130	NM	0.4	11.1	NM	1.88	0.45	-0.44	0.04	20.0	B
Petco Animal Supplies PETC (1)	1230.9	21	-46	NM	39.4	649	17	0.6	8.1	0.9	0.00	1.41	1.30	1.37	17.5	NR
Petsmart PETM (1)	3435.4	24	-33	NM	19.6	374	20	0.9	NA	1.1	0.50	1.14	1.16	1.38	19.0	B-
Pier 1 Imports PIR (2)	1101.6	13	-36	-8.5	2.5	176	75	0.6	14.5	NM	3.15	0.68	-0.11	0.30	14.0	A-
RadioShack RSH	3070.8	23	-31	3.1	69.1	612	10	0.6	6.6	1.2	1.10	2.08	1.80	1.96	11.0	B+
Rent-A-Center RCII	1386.8	20	-26	13.2	18.0	169	10	0.6	2.1	0.9	0.00	1.94	1.87	2.03	11.0	B
Ross Stores ROST (1)	4017.9	28	-5	5.9	22.5	501	23	0.8	14.0	1.4	0.87	1.13	1.33	1.71	15.0	A+
Sherwin-Williams SHW	6002.0	44	-2	128.4	26.8	342	13	0.9	10.2	1.4	1.87	2.72	3.21	3.60	10.0	A
Sonic Automotive SAH	870.9	21	-16	9.4	11.0	105	10	0.1	7.6	0.7	2.31	2.22	2.28	2.42	13.5	NR
Sports Authority TSA (1)	824.9	31	22	-18.9	9.7	157	16	0.3	7.6	1.0	0.00	1.27	2.05	2.31	15.0	NR
Staples SPLS (1)	16891.5	23	3	NA	19.1	406	22	1.1	15.5	1.3	0.72	0.93	1.11	1.25	16.0	B+
Stein Mart SMRT (1)	757.0	17	1	-0.8	17.0	244	14	0.5	10.5	0.8	1.45	0.89	1.16	1.37	18.0	[illegible]
Talbots TLB (1)	1457.9	27	[illegible]	-1.3	14.6	240	17	0.8	8.2	1.2	1.76	1.70	1.72	1.95	13.0	B+
Tiffany TIF (1)	5784.3	41	27	12.9	19.6	342	18	2.5	13.1	2.1	0.79	2.05	1.65	1.84	12.0	A
TJX TJX (1)	10324.1	22	-11	8.7	40.5	674	18	0.7	11.1	1.2	1.07	1.30	1.32	1.57	14.0	A+
Tractor Supply TSCO	2117.8	54	45	36.7	17.3	478	29	1.1	19.4	1.4	0.00	1.57	1.97	2.35	20.0	B+
Trans World Entertainment TWMC (1)	210.2	7	-48	6.3	4.0	55	17	0.2	3.8	2.8	0.00	1.06	0.23	0.39	10.0	B-
United Auto Group UAG	1668.6	36	20	25.7	10.2	148	15	0.2	10.7	1.2	1.35	2.47	2.41	2.65	12.0	B+
Williams-Sonoma WSM (1)	5000.2	43	24	34.4	20.2	487	25	1.5	15.2	1.4	0.00	1.60	1.88	2.18	17.0	B+

Investment Outlook Scoreboard

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Zale ZLC (7)	1429.6	28	-7	14.8b	12.3	139	16	0.6	9.2	1.1	0.00	1.99	2.05*	2.03	12.0	B
CONSUMER STAPLES SECTOR COMPOSITE	19014.3	37	5	15.0	34.2	537	28	1.1	11.9	2.1	1.65	1.65	2.02	2.24	9.8	
6 FOOD & STAPLES RETAILING																
INDUSTRY GROUP COMPOSITE	**16322.9**	**33**	**20**	**10.2**	**16.9**	**282**	**50**	**0.4**	**11.7**	**2.4**	**0.99**	**0.55**	**1.29**	**1.57**	**11.1**	
Albertson's ABS (1)	8671.5	24	-2	-7.9	8.8	157	18	0.2	5.3	2.6	3.23	1.28	1.29	1.32	7.0	A-
BJ's Wholesale Club BJ (1)	1791.7	26	-9	-1.7	12.8	185	15	0.2	7.9	1.3	0.00	1.66	1.85	2.06	11.0	NR
Casey's General Stores CASY (4)	1154.8	23	27	NA	13.9	227	19	0.3	10.0	1.7	0.78	0.85	1.22	1.35	11.3	A-
Costco Wholesale COST (8)	23600.4	50	3	14.0b	NA	266	23	0.4	15.3	1.9	0.92	1.85	2.18*	2.30	12.0	A-
CVS CVS	21995.9	27	20	4.7	13.3	279	21	0.6	13.0	1.4	0.54	1.10	1.37	1.57	14.0	B
Great Atlantic & Pacific Tea GAP (2)	1230.4	30	194	NM	55.5	161	3	0.1	1.8	NM	0.00	-4.77	-2.39	-0.79	2.0	C
Kroger KR (1)	14089.0	19	11	NM	0.7	345	649	0.2	10.8	1.7	0.00	-0.14	1.28	1.45	9.0	B
Longs Drug Stores LDG (1)	1595.6	43	55	-5.0	7.6	214	29	0.3	11.3	2.1	1.31	0.97	1.45	1.65	14.0	B+
Nash Finch NAFC	354.6	27	-29	-3.8	12.6	114	9	0.1	4.4	1.3	2.68	1.18	3.03	3.52	7.1	B
Pathmark Stores PTMK (1)	539.9	11	55	NM	NM	293	NM	0.1	NM	NM	NA	-10.26	-0.30	0.13	6.5	NR
Performance Food Group PFGC	1067.3	28	5	5.7	4.6	131	35	0.2	15.7	2.3	0.00	1.11	0.95	1.34	13.0	B+
Rite Aid RAD (2)	1937.6	4	1	NM	62.6	NM	11	0.1	3.8	13.9	0.00	0.47	0.04	0.11	7.0	B-
Ruddick RDK (9)	959.0	20	-7	NM	11.3	157	14	0.3	6.5	2.0	2.18	1.38	1.44*	1.52	7.0	A-
Safeway SWY	10446.2	23	18	-12.5	12.5	220	18	0.3	6.9	1.9	0.86	1.25	1.37	1.59	9.0	B
Smart & Final SMF	420.8	14	-6	12.4	6.5	158	25	0.2	11.9	0.9	0.00	0.99	0.89	1.08	17.0	C
Spartan Stores SPTN (3)	208.3	10	51	17.6a	15.5	154	10	0.1	5.1	1.0	0.00	0.96	0.86	0.98	12.0	NR
Supervalu SVU (2)	4455.5	33	-5	49.0	10.9	171	16	0.2	7.6	1.7	1.99	2.71	2.24	2.42	8.5	A-
Sysco SYY (6)	20121.5	32	-15	13.7b	34.4	740	23	0.7	15.9	1.7	2.10	1.37	1.47*	1.46	13.0	A+
United Natural Foods UNFI (7)	1163.9	28	-10	30.0b	12.7	377	30	0.5	21.7	1.5	0.00	0.78	1.00*	1.06	19.0	B+
Walgreen WAG (8)	46297.2	46	19	15.6b	17.5	521	30	1.1	22.7	1.9	0.57	1.31	1.52*	1.76	16.0	A+
Wal-Mart Stores WMT (1)	202179.0	49	-8	15.4	21.6	405	19	0.7	13.0	1.3	1.24	2.41	2.64	3.00	14.0	A+
Weis Markets WMK	1137.5	42	0	4.5	10.1	192	19	0.5	11.0	3.1	2.66	2.11	2.23	2.34	6.0	B+
Whole Foods Market WFMI (9)	10008.3	147	54	21.1b	10.0	733	74	2.1	34.7	3.7	0.81	1.98	1.98*	2.86	20.0	B
7 FOOD BEVERAGE & TOBACCO																
INDUSTRY GROUP COMPOSITE	**17984.5**	**38**	**0**	**16.8**	**42.3**	**632**	**18**	**1.4**	**11.7**	**2.0**	**2.09**	**2.21**	**2.35**	**2.56**	**8.8**	
(A) BEVERAGES																
INDUSTRY COMPOSITE	30267.7	42	5	18.2	22.7	437	19	2.0	12.4	2.0	1.53	2.26	2.19	2.42	9.7	
Anheuser-Busch BUD	33956.9	44	-14	13.1	60.1	1036	17	2.3	11.5	2.4	2.47	2.77	2.44	2.54	7.4	A+
Brown-Forman BF.B (4)	8409.5	69	41	10.7	25.5	601	24	3.9	20.6	2.4	1.63	2.52	2.78	3.03	10.5	A
Coca-Cola KO	101494.0	43	3	22.8	31.5	614	20	4.5	16.5	2.5	2.62	2.00	2.16	2.29	8.0	B+
Coca-Cola Enterprises CCE	9100.3	19	-8	23.6	11.4	159	14	0.5	5.3	1.7	0.83	1.26	1.28	1.38	9.0	B
Constellation Brands STZ (2)	5218.5	24	2	16.2	10.3	184	19	1.2	13.0	1.1	0.00	1.19	1.58	1.78	13.0	B+
Molson Coors Brewing TAP	5682.9	67	-12	15.4	3.1	106	23	1.1	10.7	1.8	1.92	5.19	3.65	4.39	10.0	A
Pepsi Bottling Group PBG	7139.0	30	0	22.4	22.3	342	16	0.6	6.6	1.6	1.08	1.73	1.86	2.00	10.0	NR
PepsiAmericas PAS	3077.0	23	8	25.9	12.1	194	16	0.8	8.2	2.1	1.49	1.28	1.36	1.48	8.0	B-
PepsiCo PEP	98331.2	59	13	14.1	27.8	694	26	3.1	18.9	2.0	1.76	2.41	2.65	2.93	10.0	A+
(B) FOOD PRODUCTS																
INDUSTRY COMPOSITE	9143.1	33	-4	16.9	20.3	357	18	1.1	11.4	2.0	1.80	1.86	2.01	2.20	8.7	
Archer Daniels Midland ADM (6)	15395.4	24	5	28.7b	11.1	178	15	0.4	9.5	1.6	1.44	0.76	1.59*	1.49	9.0	A-
Bunge BG	5967.6	54	-6	86.3	12.1	149	13	0.3	8.0	1.7	1.05	4.10	3.38	4.24	9.5	NR
Campbell Soup CPB (7)	12355.9	30	1	2.5b	51.5	817	16	1.6	11.7	2.5	2.38	1.57	1.71*	1.75	7.0	B+
ConAgra Foods CAG (5)	11151.6	22	-27	-0.4	17.6	223	13	0.8	9.1	3.2	5.07	1.27	1.34	1.43	5.0	A-
Corn Products International CPO	1613.1	22	-17	16.8	6.5	133	21	0.7	8.7	1.9	1.26	1.26	1.19	1.53	9.0	B-
Dean Foods DF	5443.5	38	16	9.5	14.1	256	20	0.5	NA	2.2	0.00	1.78	1.96	2.24	9.0	B+
Del Monte Foods DLM (4)	1969.0	10	-10	NM	10.7	164	16	0.6	9.0	1.8	0.00	0.56	0.73	0.90	7.5	NR
Flowers Foods FLO	1576.0	26	23	NM	11.3	305	28	0.9	13.4	2.4	1.54	0.81	0.97	1.16	11.0	NR
Fresh Del Monte Produce FDP	1506.5	26	-12	40.4	11.1	129	12	0.5	7.0	1.3	3.08	2.41	2.30	2.44	9.0	NR
General Mills GIS (5)	16873.2	48	-4	7.8	25.4	328	15	1.5	9.6	2.0	2.78	3.08	2.90	3.13	8.0	A-
Gold Kist GKIS (9)	820.0	10	17	NA	24.9	182	7	0.4	NA	0.8	0.00	NA	2.22*	2.38	8.5	NR
Heinz (H.J.) HNZ (4)	11619.7	35	-11	6.6	32.2	556	18	1.3	12.6	2.1	3.46	2.08	2.35	2.44	7.0	B+
Hershey HSY	13137.3	54	-2	17.4	52.9	1374	27	2.8	18.3	2.3	1.81	2.30	2.36	2.63	10.0	A-
Hormel Foods HRL (10)	4517.1	33	5	8.8b	16.1	287	18	0.8	12.6	1.9	1.71	1.65	1.82*	1.94	9.5	A
Kellogg K	18240.6	44	-1	10.2	36.6	686	19	1.8	13.2	2.1	2.52	2.14	2.35	2.55	9.0	B+
Kraft Foods KFT	48730.6	29	-19	3.5	9.4	164	17	1.5	13.2	2.2	3.18	1.55	1.86	1.92	7.0	NR
McCormick MKC (11)	4179.0	31	-19	14.3	25.8	504	20	1.6	14.6	2.0	2.31	1.52	1.60	1.75	9.0	A+
Pilgrim's Pride PPC (9)	2129.8	32	4	40.5b	21.7	174	8	0.4	5.4	0.9	0.28	2.05	3.98*	3.76	9.0	B+
Ralcorp Holdings RAH (9)	1237.1	42	-1	15.2b	13.8	239	18	0.7	9.7	2.0	0.00	2.17	2.34*	2.60	9.0	B-
Sara Lee SLE (6)	13717.3	18	-25	-15.8b	28.0	602	22	0.7	11.6	2.6	4.37	1.55	0.92*	1.26	7.5	B+
Smithfield Foods SFD (4)	3246.9	29	-1	7.9	14.9	171	12	0.3	6.6	1.3	0.00	2.64	2.32	2.63	10.0	B
Smucker (J.M.) SJM (4)	2649.3	45	-4	18.1	8.0	153	19	1.2	13.8	2.0	2.38	2.26	2.70	2.96	8.5	A
Tyson Foods TSN (9)	5974.7	17	-9	25.4b	7.6	128	17	0.2	NA	1.9	0.95	1.13	0.99*	1.15	9.0	B
Wrigley (Wm.) Jr. WWY	15383.0	69	-1	10.9	23.4	667	29	3.8	22.0	2.6	1.63	2.19	2.44	2.73	11.0	A+

Why is he so attracted?

Neil Holloway
President, Europe, Middle East & Africa
Corporate Vice President
Microsoft Corporation

Italy represents one of Microsoft's key markets in Europe. With a long tradition of innovation, a rich reservoir of creative human talent and a world-class research system, Italy is one of Europe's largest and most sophisticated ICT markets. The thriving development of mobile technologies and the explosion of broadband and digital media are shaping Italy into a truly ubiquitous network society. The latest ICT technologies are also opening up exciting new opportunities of applications across many different industries, such as Transportation, Biomedics, Home Appliances and many more. Technological innovation and early adoption have long made Italy the perfect test market for ICT investors. Microsoft is attracted. We bet you are too.

SI Sviluppoitalia

ICE Italian Trade Commission

InvestInItaly is the newly established single reference point for inward investment promotion created by Sviluppo Italia, the National Agency for enterprise and inward investment development, and ICE - Italian Trade Commission, the Government Agency which promotes the internationalization of Italian companies.

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Invest in Italy

Investment Outlook Scoreboard

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	PERCENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
(C) TOBACCO																
INDUSTRY COMPOSITE	43395.9	60	13	9.1	277.2	3413	14	2.0	12.7	1.8	5.06	4.14	4.73	4.98	7.1	
Altria Group MO	151420.2	73	19	5.2	30.1	439	15	2.2	12.6	1.7	4.40	4.57	5.12	5.51	8.5	A+
Carolina Group CG	2730.6	40	39	NA	NM	NM	12	0.8	NA	1.5	4.52	3.15	3.35	3.61	8.0	NR
Reynolds American RAI	13122.2	89	13	12.9	13.0	210	16	1.6	12.8	2.5	5.62	5.62	7.26	7.77	5.0	NR
UST UST	6310.5	39	−20	NA	788.5	9591	12	3.5	NA	1.7	5.70	3.23	3.18	3.04	7.0	A−
8 HOUSEHOLD & PERSONAL PRODUCTS																
INDUSTRY GROUP COMPOSITE	**29014.6**	**43**	**−11**	**17.5**	**42.3**	**780**	**18**	**1.6**	**13.5**	**1.7**	**1.47**	**2.16**	**2.46**	**2.64**	**10.9**	
(A) HOUSEHOLD PRODUCTS																
INDUSTRY COMPOSITE	38052.3	47	−6	19.3	39.7	821	19	1.8	13.9	1.8	1.43	2.38	2.67	2.93	10.4	
Church & Dwight CHD	2136.4	33	−1	24.8	17.3	311	19	1.2	13.2	1.5	0.72	1.36	1.80	2.04	12.0	A
Clorox CLX (6)	8180.1	54	−8	25.5b	NM	NM	18	1.8	11.5	2.1	2.14	2.28	2.88*	2.95	9.0	A
Colgate-Palmolive CL	28244.4	55	7	8.2	95.8	2122	24	2.5	17.5	2.1	2.13	2.33	2.63	2.92	10.0	A−
Energizer Holdings ENR (9)	3739.8	53	5	NM	43.1	563	14	1.3	NA	1.5	0.00	3.21	3.90*	3.95	9.0	NR
Kimberly-Clark KMB	27708.8	59	−10	2.9	27.3	459	17	1.8	11.2	2.0	3.05	3.55	3.78	3.98	8.0	A
Procter & Gamble PG (6)	195443.2	57	4	26.8b	49.2	1364	21	3.4	21.4	2.0	1.96	2.32	2.66*	2.59	11.0	A
Spectrum Brands SPC (9)	913.5	18	−41	27.5b	5.5	108	17	0.4	8.5	1.2	0.00	1.62	1.03*	2.09	14.0	NR
(B) PERSONAL PRODUCTS																
INDUSTRY COMPOSITE	7926.6	35	−23	13.9	47.5	697	18	1.3	12.2	1.5	1.56	1.64	1.96	1.97	11.8	
Alberto-Culver ACV (9)	3998.0	43	−10	15.6b	13.8	261	19	1.1	NA	1.6	1.06	1.54	2.27*	2.50	12.0	A+
Avon Products AVP	12537.0	27	−29	15.1	107.3	1412	14	1.6	11.5	1.4	2.41	1.77	1.84	1.55	11.0	A
Estee Lauder EL (6)	7244.8	33	−28	11.1b	21.5	418	20	1.1	12.9	1.5	1.21	1.62	1.78*	1.85	12.5	A−
ENERGY																
SECTOR COMPOSITE	23828.0	57	56	15.9	20.3	366	24	2.0	12.4	1.5	0.84	2.57	4.46	5.57	15.7	
9 ENERGY																
INDUSTRY GROUP COMPOSITE	**23828.0**	**57**	**56**	**15.9**	**20.3**	**366**	**24**	**2.0**	**12.4**	**1.5**	**0.84**	**2.57**	**4.46**	**5.57**	**15.7**	
(A) ENERGY EQUIPMENT & SERVICES																
INDUSTRY COMPOSITE	15364.1	56	45	28.2	15.7	400	28	2.8	18.7	1.2	0.31	1.49	2.34	3.54	26.4	
Baker Hughes BHI	19602.2	57	34	65.4	17.6	432	24	2.8	16.6	1.5	0.91	1.57	2.55	3.28	15.0	B
BJ Services BJS (9)	11790.5	37	57	7.2b	19.6	511	27	3.6	20.0	1.2	0.55	1.10	1.38*	2.00	22.0	B
Cooper Cameron CAM	4511.7	60	44	36.8	9.8	304	30	1.9	20.2	1.7	0.00	1.75	3.01	4.05	15.0	B−
FMC Technologies FTI	2822.9	41	28	46.0a	18.4	394	22	0.9	14.8	1.7	0.00	1.68	1.37	2.27	17.5	NR
Halliburton HAL	32652.5	64	62	20.0	26.9	611	22	1.6	16.7	1.2	0.79	0.87	3.08	3.67	17.5	B
Maverick Tube MVK	1633.7	38	26	70.6	19.5	228	12	1.0	NA	0.7	0.00	4.57	3.61	5.55	15.0	B−
Nabors Industries NBR	11042.5	70	36	20.9	15.3	310	21	3.5	12.6	0.4	0.00	1.92	3.99	5.71	44.5	B
National Oilwell Varco NOV	10560.2	61	72	67.9	5.7	256	34	2.7	31.7	1.2	0.00	1.27	2.01	3.03	25.0	B
Pride International PDE	4714.6	30	45	−27.9	4.7	217	45	2.4	13.0	0.6	0.00	0.10	0.78	2.08	60.0	C
Schlumberger SLB	56393.4	96	43	8.0	26.0	775	31	4.2	17.5	1.7	0.88	1.70	3.26	4.40	17.5	B−
Smith International SII	7572.7	38	39	25.4	18.2	507	32	1.4	19.6	1.5	0.64	0.89	1.46	1.94	17.0	B
Transocean RIG	21072.1	64	51	−2.0	6.0	257	44	7.5	22.9	0.8	0.00	0.47	1.60	4.46	50.0	B−
(B) OIL, GAS & CONSUMABLE FUELS																
INDUSTRY COMPOSITE	26815.2	57	59	10.7	21.9	353	22	1.7	10.4	1.6	1.03	2.95	5.21	5.29	11.4	
Alon USA Energy ALJ	913.9	20	NA	12.9a	30.7	366	10	0.4	9.4	0.7	0.00	0.72	2.08	2.33	13.6	NR
Amerada Hess AHC	11398.7	123	49	−1.8	17.6	207	12	0.6	5.5	1.4	0.98	9.50	11.21	18.62	7.7	B
Anadarko Petroleum APC	21311.5	91	40	10.6	18.9	203	11	3.3	6.4	0.7	0.79	6.36	10.36	12.33	12.0	B+
Apache APA	21496.3	65	29	19.6	24.1	224	8	3.1	5.8	0.7	0.61	5.04	8.05	8.68	11.0	B+
Arch Coal ACI	4983.6	77	117	NM	3.7	427	112	2.0	19.0	4.1	0.42	1.78	1.01	4.11	18.5	NR
Burlington Resources BR	27313.2	72	55	25.4	26.8	340	13	4.0	7.7	1.0	0.55	3.86	6.71	7.79	11.0	B
Chesapeake Energy CHK	9960.5	29	75	−15.6	15.1	315	16	2.6	6.5	1.5	0.69	1.53	2.54	3.36	7.5	B−
Chevron CVX	128660.0	57	9	NA	22.3	214	8	0.7	6.8	0.9	3.14	6.14	6.62	7.54	10.0	B+
ConocoPhillips COP	86812.5	61	39	12.6	24.8	174	7	0.6	5.3	1.3	2.05	5.79	9.27	9.23	5.0	B
Consol Energy CNX	5980.5	65	59	−1.7	61.1	652	11	1.8	7.0	0.8	0.87	1.26	2.85	4.30	30.0	NR
Crosstex Energy XTXI	834.1	65	56	NM	9.6	1234	128	0.3	23.7	4.6	2.81	0.67	0.71	2.34	20.0	NR
Devon Energy DVN	26746.9	60	55	15.2	18.8	192	11	2.7	5.5	1.1	0.50	4.38	6.61	8.67	8.0	B+
El Paso EP	7245.7	11	6	NM	−29.5	269	NM	1.6	41.2	3.7	1.46	−1.25	0.60	0.95	5.0	B−
EOG Resources EOG	17330.8	72	101	12.3	25.8	462	18	5.6	10.1	1.5	0.22	2.58	5.08	5.79	9.5	B
Exxon Mobil XOM	361085.6	58	13	14.8	31.4	335	11	1.2	8.2	1.8	2.00	3.89	5.13	5.46	6.2	A−
Frontier Oil FTO	2129.9	38	183	17.5	44.5	452	10	0.6	8.7	1.3	0.42	1.28	4.19	4.25	7.1	B−
Giant Industries GI	776.2	54	102	14.2	21.0	210	9	0.2	6.6	NA	0.00	1.43	7.63	7.96	NA	B−
Holly HOC	1831.5	61	118	65.3	34.6	471	14	0.6	10.2	NA	0.66	2.61	5.57	5.58	NA	B+
Kerr-McGee KMG	10026.5	36	50	−20.7	52.6	747	17	1.7	5.7	1.9	0.23	3.19	10.07	5.88	4.5	B
Marathon Oil MRO	21728.5	59	58	−6.4a	20.6	204	10	0.4	6.2	0.9	2.23	3.72	6.02	8.70	8.0	B+
Massey Energy MEE	2918.9	38	9	−36.0	12.5	328	29	1.4	8.4	1.1	0.42	0.18	0.85	3.40	40.0	NR
Murphy Oil MUR	9176.4	49	23	15.2	24.6	277	11	0.9	7.5	2.0	0.91	2.66	3.93	4.74	6.4	B+
Newfield Exploration NFX	5885.1	46	57	18.7	12.1	279	23	3.4	7.4	1.1	0.00	2.63	4.16	5.89	10.0	B
Occidental Petroleum OXY	31878.5	79	88	NA	35.2	229	7	2.3	5.1	1.2	1.82	6.50	9.26	10.62	6.5	B+
Peabody Energy BTU	10383.5	79	95	NA	16.1	509	32	2.3	16.5	1.0	0.48	1.40	3.02	4.38	25.0	NR
Pioneer Natural Resources PXD	6794.7	51	45	12.6	18.1	320	19	3.2	7.0	1.6	0.47	2.46	3.14	4.21	10.0	B−

Why is he so attracted?

Roberto Gradnik
Regional Vice-President, Serono

Italy is currently a key strategic location for Serono, thanks to its competitive costs, excellent research centres and high productivity, comparable to Switzerland or anywhere in Europe. This is why Serono chose to strengthen its Italian presence with a new R&D centre in Rome in 2004. Italian Life Sciences industry is the third largest in Europe, a world market leader in the sector attracting major global companies. The presence of high performing research centres with a proven track record of achievements in Healthcare research and a strong synergy between academia and industry has led to the creation of specialized biotechnology clusters, with excellent perspectives in Oncology and Neurosciences. An array of recent applications in the Biomedical, Bioinformatics, Biomechanics and Nano-biotechnology fields is catching foreign investors' attention.
Serono is attracted, we bet you are too.

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Sunoco SUN	10200.1	77	89	14.5	42.0	495	12	0.3	7.9	1.7	1.04	4.04	7.44	8.12	6.2	A–
Tesoro TSO	3825.3	55	73	28.4	23.9	209	9	0.2	6.3	1.9	0.73	4.76	8.36	8.78	3.5	B–
USEC USU	951.5	11	14	29.4	2.3	107	44	0.6	17.3	NA	5.00	0.28	0.24	0.55	NA	NR
Valero Energy VLO	29661.0	98	112	23.6	19.7	216	10	0.4	8.5	1.8	0.42	6.53	13.61	14.69	8.0	B+
Western Gas Resources WGR	3555.1	49	63	20.5	22.3	454	21	1.0	12.0	1.7	0.63	1.54	2.73	3.27	10.0	B
Williams WMB	12317.4	22	32	–41.0	6.7	239	16	1.0	11.6	1.6	1.40	0.18	0.91	1.20	15.0	B
World Fuel Services INT	847.5	34	36	21.0	11.1	248	22	0.1	21.2	NA	0.44	1.22	1.60	1.77	NA	A–
XTO Energy XTO	14776.5	41	53	18.2	24.3	412	17	5.0	10.1	1.3	0.74	1.51	3.05	3.32	10.0	B+
FINANCIALS																
SECTOR COMPOSITE	21508.9	792	10	21.0	14.4	239	20	2.1	15.7	1.8	2.07	43.92	28.64	33.15	10.8	
10 BANKS																
INDUSTRY GROUP COMPOSITE	**24381.7**	**47**	**–2**	**16.7**	**15.4**	**202**	**14**	**2.7**	**10.6**	**1.3**	**2.95**	**3.34**	**3.64**	**3.88**	**10.0**	
(A) COMMERCIAL BANKS																
INDUSTRY COMPOSITE	26341.9	47	–2	17.5	15.4	211	14	2.7	10.8	1.4	3.16	3.23	3.46	3.68	9.8	
AmSouth Bancorporation ASO	9268.3	27	3	19.3	20.1	258	13	2.9	11.0	1.6	3.91	1.74	2.03	2.12	8.0	A–
Bank of America BAC	184159.5	46	–2	13.0	16.7	182	11	2.3	9.8	1.2	4.36	3.69	4.30	4.41	9.0	A–
BB&T BBT	23319.6	43	1	16.3	14.7	208	14	3.1	NA	1.4	3.57	2.80	3.06	3.30	10.0	A–
Comerica CMA	9530.9	58	–5	0.3	16.9	187	11	2.8	NA	1.4	3.81	4.36	5.04	4.87	8.0	A
Commerce Bancorp CBH	5826.6	34	5	27.3	14.7	276	19	2.9	NA	1.3	1.31	1.63	1.79	1.95	15.0	A+
Compass Bancshares CBSS	6033.8	48	0	11.6	18.1	271	15	2.9	11.9	1.5	2.89	2.95	3.25	3.55	10.0	A+
Fifth Third Bancorp FITB	22325.7	40	–15	10.0	14.8	238	16	3.2	NA	1.4	3.77	2.68	2.90	3.04	10.0	A+
First Horizon National FHN	4904.0	39	–10	18.9	19.1	217	12	1.6	6.8	1.4	4.62	3.54	3.40	3.55	8.0	A+
Huntington Bancshares HBAN	5487.0	24	–3	7.3	15.4	209	14	2.5	8.9	2.1	3.59	1.71	1.79	1.87	6.5	B+
KeyCorp KEY	13547.3	33	–2	0.0	13.9	180	13	2.1	NA	1.5	3.92	2.30	2.68	2.79	8.0	A–
M&T Bank MTB	12201.4	108	0	16.7	13.2	209	16	3.4	12.9	1.6	1.66	6.00	6.69	7.33	10.0	A+
Marshall & Ilsley MI	10076.5	43	–3	17.4	15.8	222	14	2.7	NA	1.4	2.23	2.77	3.01	3.25	10.0	A
National City NCC	21325.8	34	–10	19.3	19.7	165	9	2.0	5.9	1.3	4.36	4.31	3.17	3.13	8.0	A
North Fork Bancorporation NFB	12905.1	27	–6	18.8	10.4	139	13	3.8	11.8	1.3	3.26	1.85	2.05	2.16	10.0	A
PNC Financial Services Group PNC	18557.1	64	11	0.7	15.4	223	14	2.5	NA	1.8	3.14	4.21	4.38	4.88	8.0	B+
Popular BPOP	5925.5	22	–23	16.0	16.2	195	11	1.8	9.5	1.2	2.89	1.79	1.92	1.86	10.0	A+
Regions Financial RF	15437.0	34	–5	3.3	9.2	145	16	2.6	14.2	1.8	4.04	2.19	2.39	2.62	8.0	A–
SunTrust Banks STI	26277.2	73	–2	4.8	11.5	157	14	2.6	NA	1.4	3.02	5.19	5.59	6.00	9.0	A+
Synovus Financial SNV	8790.8	28	–2	11.3	17.3	306	18	2.8	NA	1.3	2.59	1.41	1.65	1.84	13.5	A+
TD Banknorth BNK	5152.9	30	–60	7.3	3.7	80	20	3.0	14.2	1.3	2.96	3.57	2.50	2.60	9.0	A–
U.S. Bancorp USB	55041.4	30	–3	11.3	22.2	277	13	3.4	NA	1.3	3.96	2.18	2.42	2.62	10.0	B+
UnionBanCal UB	10005.3	69	7	15.7	17.2	230	14	3.4	NA	1.4	2.37	4.87	5.00	5.37	10.0	A
Wachovia WB	82930.2	53	2	137.4	13.7	177	13	2.4	10.6	1.2	3.82	3.81	4.30	4.72	10.0	A–
Wells Fargo WFC	105535.8	63	1	15.2	18.9	265	14	2.7	9.2	1.3	3.31	4.09	4.52	5.02	11.0	A
Westcorp WES	3513.4	67	46	11.9	16.2	229	14	2.4	13.4	0.9	0.89	3.96	4.84	5.43	15.0	B+
Zions Bancorporation ZION	6811.8	76	11	24.5	15.2	227	15	3.1	12.6	1.3	1.90	4.47	5.18	5.51	11.0	A
(B) THRIFTS & MORTGAGE FINANCE																
INDUSTRY COMPOSITE	15887.7	47	–1	11.7	15.4	163	11	2.7	9.5	1.0	1.52	3.82	4.46	4.74	10.7	
Countrywide Financial CFC	20787.9	35	–6	NA	18.5	170	8	1.3	NA	0.7	1.72	3.63	4.14	4.40	12.0	A–
Golden West Financial GDW	19928.3	66	5	24.8	17.3	241	14	3.3	13.4	1.1	0.49	4.13	4.73	5.34	13.0	A+
MGIC Investment MTG	5938.3	65	–6	2.8	14.9	140	10	3.8	9.1	1.0	0.92	5.63	6.73	6.75	10.0	A
Radian Group RDN	4693.7	57	8	13.4	16.1	131	9	3.4	NA	1.0	0.14	5.33	5.54	5.92	10.0	A
Sovereign Bancorp SOV	7827.9	22	–3	NM	11.4	138	13	2.4	9.6	1.3	1.10	1.36	1.82	1.93	9.0	B+
Washington Mutual WM	36150.4	41	–3	6.0	14.3	160	11	1.9	6.0	1.1	4.76	2.81	3.80	4.07	10.0	A
11 DIVERSIFIED FINANCIALS																
INDUSTRY GROUP COMPOSITE	**36284.9**	**59**	**14**	**15.4**	**20.1**	**409**	**18**	**2.8**	**15.0**	**1.4**	**1.32**	**3.33**	**3.83**	**4.22**	**12.0**	
(A) CAPITAL MARKETS																
INDUSTRY COMPOSITE	23566.0	65	20	12.1	15.4	277	18	2.6	15.9	1.5	1.20	3.66	4.27	4.65	11.9	
Ameriprise Financial AMP	10352.7	42	NA	NA	8.8	134	15	1.4	NA	1.5	1.05	NA	2.75	3.15	10.0	NR
Bank of New York BK	24945.1	32	–3	–0.9	15.8	260	17	3.1	12.3	1.5	2.59	1.85	2.04	2.27	10.8	A–
Bear Stearns BSC (11)	12541.1	111	8	16.2	14.0	132	11	1.2	7.7	1.0	0.90	9.76	10.16	10.88	10.5	A
E*Trade Financial ET	7305.6	20	31	97.9	16.2	291	18	3.1	14.5	1.4	0.00	0.92	1.07	1.29	13.0	B–
Edwards (A.G.) AGE (2)	3383.0	44	2	–8.8	10.9	182	17	1.3	NA	1.7	1.82	2.37	2.80	3.15	9.5	A–
Franklin Resources BEN (9)	23475.0	93	33	20.7b	18.6	413	23	5.4	23.8	1.6	0.43	2.73	4.06*	4.68	14.5	A–
Goldman Sachs Group GS (11)	58491.0	126	24	10.4	19.5	226	13	1.5	10.1	1.0	0.78	8.92	11.19	11.37	12.0	NR
Legg Mason LM (3)	14031.2	123	67	NA	15.1	516	36	6.1	30.0	2.0	0.59	3.53	4.14	5.55	15.0	A
Lehman Brothers Holdings LEH (11)	33938.0	126	34	5.5	18.1	223	13	1.2	9.8	1.0	0.63	7.90	10.76	10.78	12.0	A
Mellon Financial MEL	14065.7	34	8	5.6	21.6	336	16	2.6	13.4	1.8	2.38	1.89	1.88	2.08	10.0	A–
Merrill Lynch MER	61036.7	60	11	4.0	14.5	191	13	1.4	11.3	1.1	1.20	4.38	5.08	5.60	12.0	A–
Morgan Stanley MWD (11)	60665.2	56	1	–3.6	16.5	215	13	1.3	NA	1.1	1.93	4.08	4.35	5.01	12.0	A–
Northern Trust NTRS	11499.4	53	8	NA	16.1	326	21	3.4	17.2	1.7	1.75	2.26	2.64	2.93	12.0	A–
Raymond James Financial RJF (9)	2721.8	36	17	10.9b	12.2	219	18	1.3	17.7	1.8	1.32	1.72	2.00*	2.36	10.0	B+
Schwab (Charles) SCH	24680.1	15	20	–7.5	14.8	453	32	4.0	22.9	1.8	0.66	0.30	0.57	0.70	15.0	B+
State Street STT	19925.0	56	17	6.7	14.4	310	22	2.7	NA	1.7	1.25	2.35	2.81	3.17	12.0	B

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InvestInItaly:

taly is ready to welcome nvestors the world over

vestInItaly is the Italian organization for investment promotion. It has een established in 2004 by Sviluppo Italia – the National Agency for nterprise and Inward Investment Development –, and the Italian Trade ommission – the Government Agency which promotes the ternationalization of Italian companies.

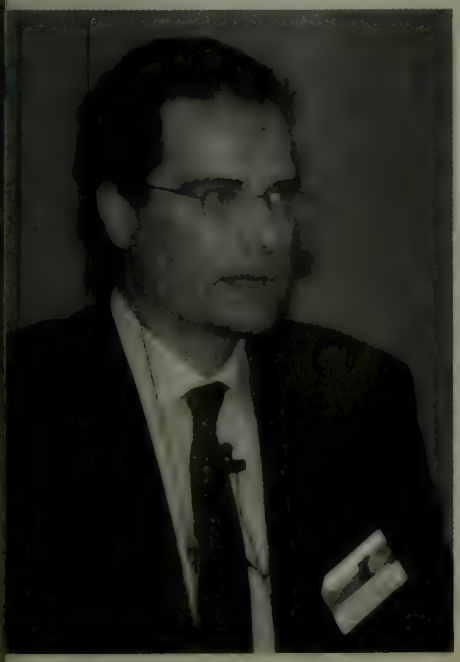
/ith InvestInItaly the investor can rely on a single reference point to ipport her/his business venture throughout the investment process: om location scouting to set up phase, from incentive negotiations to ublic Administration dealings and after care services. The services fered are free of charge and strictly confidential.

killed and multilingual staff with international background and ompetences on industrial sectors, business needs, and Corporate Law able to provide the investor with one-to-one assistance and effective ipport to turn a project into a successful business.

/ith headquarters in Rome, InvestInItaly relies on a fully integrated etwork of 18 Sviluppo Italia regional companies, 9 information desks f the Italian Trade Commission, and a pool of selected partners for usiness development support.

Veigh up Italy's advantages and judge yourself

Giampaolo Russo - Head of Inward Investment Development at InvestInItaly



Investors should discard any old-fashioned view of how we do business in Italy and make the most of the new opportunities offered by Italy's potential for expansion.

Recent reforms in the Labour Market, the Corporate and Company Law, and the Taxation Law have revolutionized the business environment, making it easier and faster set up a business in the country. The results include more flexibility in the workplace, simplified procedures and reduction in the tax burden.

What is more the Italian Government considers as strategic the attraction of foreign investments: hence the creation in 2004 of InvestInItaly the National Agency dedicated to the promotion of foreign direct investments. InvestInItaly is a single reference point for investors offering professional services aimed at facilitating the setting up of business ventures in the country.

InvestInItaly also works to advise investors about the competitive advantage Italy has in several key sectors.

Italy is first for Biotechnology developments in Europe and in many ways the country is a leader when it comes to technology. It has the greater penetration of mobile phones in the world and it is second in Europe for number of users with 56 million active SIM cards. Suffice it to say that Vodafone Italia is one of the most profitable business unit of the Vodafone Group.

Italy is also at the forefront of Broadband with 40% growth forecast for 2007; it was in fact selected among other European countries by ITU - International Telecommunication Union - as the most representative case of "Ubiquitous society" for the huge convergence and diffusion of IT technologies in everyday life. According to ITU, Italy's constant development across the ICT world, namely, the extraordinary growth of Broadband, the diffusion of Digital Terrestrial TV, and its many positive achievements, set the country to become a truly ubiquitous network society with well-established ICT infrastructures.

Italy is the ideal country to test advanced products. Its 58 million consumers are very technology aware and like to be the first to use stylish products with innovative functionalities.

Investors will find plenty of high qualified workforce – each year 46,000 science and engineering students graduate to join the job market – with the highest rate of patent productivity in Europe.

Investors setting up a business in Italy can benefit from different types of incentives. Many Italian Regions have EU, national, and regional backed founding to be used to start-up businesses.

In addition there is the potential to collaborate with over 200 institutional R&D centres located all across the country. Furthermore, the costs of setting up an R&D centre are lower in Italy than in other countries such as the UK, France, USA, and Germany. All of the major technology companies have set up operations.

Italy represents the ideal platform for expansion into emerging markets. Located at the heart of the Mediterranean, the country has excellent transport links which allow to reach Northern Africa and the Middle East with some 240 million potential consumers.

It is time to forget out-mode views and let Italy's excellence speak for itself. I am confident that the prospective investor who will look into Italy's benefits and weigh them up against those of other nations will discover our country to be an attractive option for investment.

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
(B) CONSUMER FINANCE																
INDUSTRY COMPOSITE	28973.6	48	-3	24.0	24.2	399	16	2.7	11.8	1.3	0.97	3.28	3.11	3.53	12.8	
American Express AXP	63709.4	51	-9	7.3	34.0	643	19	2.5	NA	1.5	0.93	2.74	2.59	2.96	13.5	A-
AmeriCredit ACF (6)	3417.9	25	1	-9.7b	13.6	172	15	2.2	11.1	1.1	0.00	1.37	1.73*	[illegible]	12.5	B
Capital One Financial COF	22144.7	83	-1	29.0	15.6	201	13	1.9	10.4	1.0	0.13	6.21	6.72	7.70	13.0	A+
MBNA KRB	33598.6	27	-5	19.1	16.1	254	16	2.7	NA	1.3	2.09	2.05	2.01	2.18	10.0	A+
SLM SLM	21997.3	53	-2	74.5a	41.4	675	15	4.0	13.7	1.4	1.67	4.04	2.51	2.94	15.0	A-
(C) DIVERSIFIED FINANCIAL SERVICES																
INDUSTRY COMPOSITE	84296.9	49	14	15.4	31.2	853	19	3.6	14.7	1.5	2.02	2.39	3.16	3.51	11.4	
CIT Group CIT	9913.3	50	8	4.9a	13.0	163	12	1.9	5.4	1.2	1.29	3.50	4.15	4.68	10.0	NR
Citigroup C	245613.3	49	1	8.3	17.8	222	13	2.1	10.9	1.2	3.63	3.26	4.00	4.35	10.0	A+
JPMorgan Chase JPM	134005.3	38	-2	-14.2	7.0	126	18	1.8	11.2	1.3	3.56	1.55	2.94	3.37	10.0	B
Moody's MCO	17769.9	60	39	30.2	107.2	3571	35	10.8	31.3	2.3	0.37	1.40	1.78	1.99	15.0	B+
Principal Financial Group PFG	14182.5	51	24	47.8a	10.9	182	18	1.6	NA	1.4	1.28	2.23	2.91	3.14	12.0	NR
12 INSURANCE																
INDUSTRY GROUP COMPOSITE	**14672.6**	**1682**	**15**	**29.0**	**11.7**	**165**	**20**	**1.3**	**19.6**	**1.5**	**1.49**	**93.94**	**58.76**	**81.57**	**11.0**	
ACE ACE	16021.3	56	30	15.4	10.0	157	16	1.2	15.0	1.3	1.62	3.88	3.71	6.24	11.7	B
AFLAC AFL	24013.6	48	20	18.9	19.2	300	16	1.7	NA	1.2	0.92	2.52	2.59	2.92	15.0	A
Allstate ALL	36465.0	56	8	12.9	9.6	135	21	1.0	NA	2.3	2.28	4.79	2.43	6.15	10.0	B+
Ambac Financial Group ABK	8064.0	77	-7	18.1a	14.2	155	12	5.1	NA	1.0	0.78	6.54	6.39	7.03	12.5	A+
American Financial Group AFG	2878.2	37	19	NM	8.8	120	13	0.7	7.1	1.4	1.35	4.92	3.23	3.98	8.0	B
American International Group AIG	174269.1	67	2	12.6	12.7	195	16	1.6	NA	1.2	0.89	3.75	4.35	5.56	13.0	A+
AmerUs Group AMH	2270.0	59	30	17.2	12.0	146	12	1.4	NA	1.3	0.68	4.60	4.52	4.99	10.0	B
Aon AOC	11651.7	36	53	-1.1	10.9	219	21	1.2	NA	2.2	1.65	1.72	2.08	2.38	8.0	B+
Assurant AIZ	5849.1	44	44	31.3	11.7	160	14	0.8	NA	1.3	0.73	2.53	3.47	3.74	10.0	NR
Berkley (W.R.) BER	5940.5	47	48	68.3	20.4	245	13	1.2	10.7	1.0	0.43	3.32	3.80	4.43	12.0	B
Berkshire Hathaway BRK.A	137660.6	89390	2	21.4	7.5	154	20	1.8	NA	NA	0.00	4753.00	3050.00	4212.50	NA	B
Chubb CB	19359.4	97	26	18.9	14.8	171	12	1.4	10.9	1.1	1.78	8.01	7.58	8.82	11.1	B+
Cincinnati Financial CINF	7789.3	45	6	48.9	10.2	129	13	2.1	12.2	1.5	2.74	3.28	2.99	3.01	10.0	A-
CNA Financial CNA	8715.5	34	27	-30.8	7.5	101	12	0.9	10.5	1.7	0.00	1.47	2.13	3.23	9.5	C
Commerce Group CGI	1953.9	58	-5	13.9	20.0	155	8	1.0	NA	NA	2.62	6.51	6.47	5.63	NA	B+
Conseco CNO	3391.5	22	12	NA	7.5	103	12	0.8	4.6	1.3	0.00	NA	1.77	1.90	9.5	NR
Everest Re Group RE	5897.2	105	17	21.3	1.0	164	188	1.2	160.0	NM	0.42	8.71	-1.34	12.37	14.1	A
Fidelity National Financial FNF	6562.8	38	-17	40.8	28.1	180	7	0.7	4.6	0.8	2.64	4.21	3.90	3.54	12.0	B+
Fidelity National Title Group FNT	3956.3	23	NA	NA	23.2	165	NA	0.6	6.3	0.9	4.39	NA	3.16	2.77	8.0	NR
First American FAF	4503.2	47	34	32.6	14.9	153	10	0.6	7.7	0.8	1.53	3.83	4.87	4.10	11.5	B+
Gallagher (Arthur J.) AJG	2898.8	30	-6	17.6	8.9	370	41	1.9	23.2	1.5	3.68	1.99	1.83	1.94	11.0	A+
Genworth Financial GNW	16226.0	34	28	NA	9.5	122	13	1.5	NA	1.2	0.87	2.33	2.51	2.75	11.5	NR
Hanover Insurance Group THG	2145.3	40	22	-2.1	3.0	115	39	0.8	NA	6.9	0.63	3.40	0.46	3.48	12.5	B-
Hartford Financial Services Group HIG	26223.1	87	26	13.5	15.9	171	11	1.0	NA	1.0	1.37	7.20	7.59	8.48	12.0	B
Jefferson-Pilot JP	7444.3	56	7	5.3	14.9	193	13	1.8	NA	1.5	3.01	4.04	4.13	4.26	9.0	A+
LandAmerica Financial Group LFG	1139.6	65	20	NM	10.9	95	9	0.3	6.1	1.1	1.11	8.01	6.76	5.69	9.0	B
Lincoln National LNC	9003.8	52	11	11.8a	12.7	143	12	1.7	9.4	1.0	2.92	4.09	4.56	4.52	12.0	B+
Loews LTR	17939.5	97	37	-11.6	12.3	140	13	1.2	NA	1.6	0.62	5.64	7.33	9.90	8.0	B-
Markel MKL	3108.7	317	-13	NM	4.7	195	45	1.4	NA	4.4	0.00	16.41	6.20	24.67	11.5	B-
Marsh & McLennan MMC	16805.0	31	-6	-36.2	-5.9	314	NM	1.4	89.9	2.0	2.20	0.34	1.41	2.05	11.0	A-
MBIA MBI	8282.3	62	-2	NA	11.6	128	12	3.7	NA	0.9	1.81	5.61	5.54	5.95	12.0	A
Mercury General MCY	3237.5	59	-1	26.9	17.6	203	12	1.1	10.8	1.6	2.90	5.24	4.83	4.92	7.5	B+
MetLife MET	38943.0	51	27	NA	10.5	135	13	0.9	NA	1.2	1.01	3.59	4.30	4.46	10.0	NR
Nationwide Financial Services NFS	6457.4	42	10	-0.6	11.5	120	11	1.5	NA	1.2	1.80	3.30	3.90	3.91	9.1	B+
Odyssey Re Holdings ORH	1669.4	26	2	24.2	2.1	108	56	0.6	NA	NM	0.49	2.71	-1.66	2.49	12.0	NR
Ohio Casualty OCAS	1895.5	30	28	NM	13.8	136	10	1.1	9.0	1.4	0.81	1.91	2.16	2.36	10.0	B-
Old Republic International ORI	4875.6	27	5	9.4	12.3	118	10	1.3	NA	1.1	2.56	2.36	2.52	2.62	10.0	A-
PartnerRe PRE	3690.8	58	10	37.9	3.0	120	39	0.9	29.2	NM	2.23	8.71	-4.00	7.87	12.0	B
Phoenix PNX	1293.4	14	9	-1.7	5.2	63	13	0.5	NA	1.5	1.18	0.86	0.94	0.91	10.0	NR
Progressive PGR	24241.3	123	45	145.5	26.3	417	16	1.7	15.0	1.7	0.10	7.63	7.34	7.23	10.0	B+
Protective Life PL	3079.0	44	3	14.1	10.7	140	13	1.5	12.2	1.3	1.77	3.52	3.58	3.86	9.5	A
Prudential Financial PRU	39241.7	77	41	NA	16.1	166	12	1.3	NA	1.2	1.01	3.45	4.97	5.49	13.0	NR
Reinsurance Group of America RGA	2961.6	47	-2	16.5	8.8	117	14	0.7	NA	1.3	0.76	3.90	3.41	4.35	11.0	B+
Safeco SAFC	6975.0	56	8	227.3	17.0	174	11	1.1	9.5	0.9	1.78	4.59	4.96	5.27	12.0	B
Selective Insurance Group SIGI	1579.3	56	27	41.7	15.8	166	12	0.9	9.2	1.3	1.57	4.07	4.23	4.47	10.0	B+
St. Paul Travelers STA	32208.1	47	26	-21.1	9.8	145	15	1.3	11.2	1.3	1.98	1.53	3.68	5.16	10.0	NR
StanCorp Financial Group SFG	2819.9	103	25	23.7	14.4	199	14	1.2	NA	1.4	1.21	6.90	7.13	7.74	10.4	NR
Stewart Information Services STC	917.3	51	21	226.2	12.9	119	9	0.4	6.9	1.0	1.48	4.53	5.65	4.75	8.0	B
Torchmark TMK	5616.4	54	-5	10.8	14.4	167	12	1.8	NA	1.2	0.81	4.25	4.59	4.96	10.0	A
Transatlantic Holdings TRH	4604.3	70	13	4.5	4.9	101	38	1.2	37.3	3.8	0.69	3.85	1.21	6.19	15.0	B+
21st Century Insurance Group TW	1467.8	17	26	61.9	10.3	181	12	1.0	12.6	1.0	0.94	1.03	0.97	0.95	17.0	B-
[illegible]	1643.0	36	8	23.0	25.1	197	8	0.8	6.9	NA	1.40	3.07	4.28	3.39	NA	B-

Investment Outlook Scoreboard

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Unitrin UTR	3264.5	47	4	27.4	11.5	156	14	1.1	13.5	1.1	3.59	3.48	2.59	3.09	17.0	B
UnumProvident UNM	6556.4	22	23	NM	7.1	91	13	0.6	6.2	1.3	1.36	–0.65	1.69	1.88	10.0	B–
XL Capital XL	9328.1	66	–15	19.2	–2.6	133	NM	0.9	NM	NM	3.01	8.13	–7.63	8.89	10.9	B
13 REAL ESTATE																
INDUSTRY GROUP COMPOSITE	**8994.7**	**43**	**12**	**–2.0**	**10.1**	**346**	**57**	**3.5**	**17.4**	**7.2**	**5.31**	**1.75**	**2.07**	**2.12**	**8.1**	
CB Richard Ellis Group CBG	4059.5	56	65	NA	26.8	578	22	1.5	17.4	1.9	0.00	0.91	2.79	3.16	10.5	NR
Equity Office Properties Trust EOP	12738.2	31	7	–33.5	2.2	149	61	4.1	NA	32.0	6.41	0.28	0.33	1.22	3.0	NR
Equity Residential EQR	11745.6	41	13	NA	1.9	247	83	5.8	NA	4.3	4.24	0.37	1.89	0.87	5.0	B+
General Growth Properties GGP	10883.8	46	26	12.4	4.7	558	114	3.7	NA	NA	3.59	1.15	0.53	0.68	NA	A–
Host Marriott HMT	6324.1	18	3	NA	3.0	304	90	1.7	NA	4.9	2.46	–0.31	0.37	0.69	10.0	C
New Century Financial NEW	2043.7	36	–43	NM	17.9	97	5	0.9	NA	0.9	18.25	8.29	7.03	6.59	6.0	NR
Plum Creek Timber PCL	7168.6	39	1	6.7	13.7	309	23	4.7	NA	4.4	3.90	1.84	1.78	1.78	5.0	NR
Simon Property Group SPG	16993.7	77	20	6.2	10.8	523	59	5.4	NA	2.4	3.62	1.44	1.89	1.96	17.0	B+
HEALTH CARE SECTOR COMPOSITE	20269.8	49	16	22.3	15.5	403	34	2.5	20.9	1.7	0.60	1.82	2.24	2.59	14.5	
14 HEALTH CARE EQUIPMENT & SERVICES																
INDUSTRY GROUP COMPOSITE	**10905.2**	**49**	**17**	**26.6**	**15.9**	**374**	**25**	**1.7**	**19.6**	**1.5**	**0.35**	**1.99**	**2.31**	**2.68**	**14.9**	
(A) HEALTH CARE EQUIPMENT & SUPPLIES																
INDUSTRY COMPOSITE	12846.5	49	0	15.2	13.7	400	29	3.1	19.5	1.6	0.64	1.83	2.21	2.57	14.4	
Bard (C.R.) BCR	6802.8	65	1	28.3	21.1	440	21	3.9	17.6	1.4	0.80	2.82	3.00	3.42	15.1	B+
Bausch & Lomb BOL	4345.1	81	26	18.4	10.1	296	30	1.8	14.5	1.5	0.64	2.93	3.66	4.29	15.0	B
Baxter International BAX	24211.5	39	12	–16.1	17.6	553	32	2.4	17.8	1.8	1.50	0.62	1.89	2.16	11.7	B+
Beckman Coulter BEC	3458.4	56	–17	12.1	16.3	293	19	1.4	NA	1.3	1.01	3.21	3.00	2.99	14.0	B+
Becton, Dickinson BDX (9)	14554.3	58	3	14.1a	21.0	442	22	2.7	NA	1.8	1.48	2.21	2.66*	3.19	12.0	A
Biomet BMET (5)	8874.6	36	–18	17.3	25.4	575	23	4.6	19.2	1.3	0.70	1.38	1.77	2.02	15.0	A
Boston Scientific BSX	21699.9	26	–26	28.1	15.2	556	39	3.4	23.9	1.2	0.00	1.24	1.83	1.87	12.0	B
Dade Behring Holdings DADE	3604.4	41	46	NA	12.3	388	33	2.2	12.9	2.0	0.29	0.88	1.40	1.51	15.0	NR
Dentsply International XRAY	4360.6	56	–1	19.6	9.2	347	40	2.5	26.1	1.4	0.50	2.56	2.63	2.92	15.0	A
Fisher Scientific International FSH	7898.2	64	3	37.1	7.3	189	27	1.4	15.6	1.2	0.00	1.80	3.55	4.08	15.0	B–
Guidant GDT	20439.9	62	–14	8.6	10.6	451	42	5.5	31.3	2.0	0.65	1.78	2.03	2.44	15.0	B
Hillenbrand Industries HB (9)	2969.3	49	–12	–12.1b	–8.6	265	30	1.5	NA	NA	2.33	3.00	1.61*	3.01	NA	B+
Hospira HSP	7097.4	44	32	0.3	19.9	547	27	2.6	16.9	2.7	NA	1.92	2.02	2.19	8.0	NR
Invacare IVC	1083.6	34	–26	4.6	8.1	141	18	0.7	10.5	1.7	0.15	2.33	1.99	2.31	10.0	B+
Medtronic MDT (4)	67073.0	56	12	14.9	16.8	602	36	6.2	28.1	1.7	0.69	1.48	2.22	2.52	15.0	B+
PerkinElmer PKI	2972.6	23	1	–3.9	7.4	200	27	1.9	16.4	1.3	1.23	0.76	1.07	1.23	17.0	B
St. Jude Medical STJ	17462.6	48	14	30.4	18.2	620	35	6.4	27.7	2.0	0.00	1.10	1.53	1.77	15.9	B
Stryker SYK	17488.9	43	–10	20.0	20.9	562	27	3.7	21.6	1.2	0.25	1.14	1.75	2.09	20.0	B+
Thermo Electron TMO	5003.1	31	2	43.4	8.3	181	22	2.0	15.0	1.3	0.00	1.31	1.53	1.78	15.0	B–
Zimmer Holdings ZMH	15529.6	63	–22	24.6	16.3	345	21	4.8	17.0	1.2	0.00	2.19	3.07	3.60	17.0	NR
(B) HEALTH CARE PROVIDERS & SERVICES																
INDUSTRY COMPOSITE	9958.2	49	26	34.3	17.0	362	23	1.0	19.6	1.4	0.21	2.06	2.36	2.73	15.1	
Aetna AET	26453.2	92	48	NM	16.2	284	19	1.2	15.5	1.3	0.04	3.87	4.60	5.51	16.0	NR
Amerigroup AGP	960.0	19	–51	21.0	10.1	153	15	0.4	10.9	1.5	0.00	1.66	0.89	1.16	14.0	NR
AmerisourceBergen ABC (9)	8310.8	80	37	6.8b	6.8	194	29	0.2	22.3	2.4	0.25	4.12	2.73*	4.08	12.3	A–
Apria Healthcare Group AHG	1212.1	24	–26	21.0	15.5	252	16	0.8	5.6	1.0	0.00	2.27	1.68	1.78	15.0	B–
Beverly Enterprises BEV	1305.6	12	30	NM	25.7	357	15	0.6	8.0	0.4	0.00	0.37	0.96	0.94	35.0	B–
Cardinal Health CAH (6)	27370.6	64	10	6.7b	12.0	308	26	0.4	18.4	2.1	0.38	3.47	2.40*	3.39	13.0	A+
Caremark Rx CMX	22847.1	51	30	35.0	10.7	289	28	0.7	23.0	1.3	0.00	1.43	1.97	2.34	20.0	B–
Cigna CI	14152.8	113	38	18.5	28.7	250	9	0.8	7.7	1.4	0.09	11.44	7.80	7.86	10.0	B+
Community Health Systems CYH	3587.6	40	44	77.3	13.3	266	21	1.0	10.5	1.4	0.00	1.58	1.98	2.29	15.0	NR
Coventry Health Care CVH	9677.4	60	65	56.5	19.3	400	20	1.5	18.2	1.3	0.00	2.48	3.13	3.56	15.0	B
DaVita DVA	5334.2	52	33	110.5	28.6	690	24	2.1	16.6	1.6	0.00	2.16	2.12	2.45	15.0	B
Express Scripts ESRX	12300.3	84	121	NM	27.7	923	34	0.8	27.4	1.8	0.00	1.80	2.58	3.16	18.0	B+
Genesis HealthCare GHCI (9)	830.6	42	20	NA	6.5	128	20	0.5	NA	1.3	0.00	1.58	2.12*	2.14	15.0	NR
HCA HCA	23081.5	51	28	60.4	22.3	363	16	1.0	8.3	1.4	1.18	2.58	3.00	3.24	12.0	B
Health Management Associates HMA (9)	5788.9	23	3	16.9b	15.4	253	16	1.6	11.4	1.2	1.02	1.32	1.42*	1.56	14.0	A–
Health Net HNT	5837.0	51	77	–26.9	4.5	389	91	0.5	56.1	1.8	0.00	0.38	2.41	3.00	12.0	B–
Humana HUM	7459.7	46	54	33.6	12.3	315	26	0.5	17.8	1.5	0.00	1.72	2.10	2.73	15.0	B
IMS Health RX	5665.0	24	5	36.1	64.9	1371	21	3.3	15.3	1.5	0.33	1.20	1.35	1.51	12.5	B+
Kindred Healthcare KND	1081.2	28	–7	NM	14.8	124	10	0.3	4.7	1.2	0.00	2.03	1.89	2.06	12.5	NR
Laboratory Corp. of America Holdings LH	6932.5	52	4	32.3	17.6	319	20	2.1	13.2	1.6	0.00	2.45	2.78	3.11	12.0	B
Magellan Health Services MGLN	1068.1	29	–14	98.5	15.7	177	11	0.6	7.5	0.9	0.00	2.33	2.62	1.69	12.0	NR
Manor Care HCR	3103.1	39	11	49.5	23.3	409	19	0.9	9.9	1.3	1.52	1.90	2.04	2.26	15.0	B
McKesson MCK (3)	15492.4	50	60	NM	–1.4	265	NM	0.2	137.6	1.6	0.48	–0.53	2.27	2.66	13.8	B
Medco Health Solutions MHS	16472.6	54	29	21.6	7.2	213	27	0.5	18.3	1.5	0.00	1.75	2.32	2.63	15.0	NR
Omnicare OCR	6069.9	57	65	42.2	10.9	282	26	1.3	22.3	1.5	0.16	2.17	2.48	3.23	15.0	A–
Owens & Minor OMI	1131.7	28	1	13.0	12.8	226	18	0.2	13.9	1.3	1.83	1.53	1.66	1.84	13.0	A–
PacifiCare Health Systems PHS	7558.0	66	52	8.7	14.6	299	23	0.5	16.8	1.5	0.00	3.20	3.67	4.74	15.5	B

Investment Outlook Scoreboard

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Patterson Companies PDCO (4)	4831.4	35	-19	23.4	16.9	434	26	1.9	22.7	1.4	0.00	1.32	1.43	1.65	18.0	B+
PSS World Medical PSSI (3)	1086.3	16	32	NM	14.3	356	25	0.7	18.0	1.3	0.00	0.60	0.63	0.76	20.0	NR
Quest Diagnostics DGX	10108.2	50	5	43.4	19.2	357	19	1.9	14.2	1.3	0.72	2.35	2.66	3.05	14.0	B-
Renal Care Group RCI	3208.3	47	30	24.7	18.4	458	26	2.1	16.2	1.6	0.00	1.74	2.02	2.31	15.0	NR
Schein (Henry) HSIC	3729.5	43	23	43.2	11.6	311	27	0.8	18.6	1.6	0.00	1.43	1.81	2.22	15.0	B
Sierra Health Services SIE	2258.1	78	42	NM	47.3	893	22	1.7	16.7	1.4	0.00	3.58	3.51	4.03	16.0	B-
Sunrise Senior Living SRZ	1427.7	33	44	19.5	7.4	249	35	0.9	20.8	NA	0.00	1.12	0.98	1.15	NA	[illegible]
Tenet Healthcare THC	3670.8	8	-29	NM	NM	269	NM	0.4	NM	NM	0.00	-3.85	-0.22	0.00	10.0	C
Triad Hospitals TRI	3673.4	43	15	NM	7.9	128	15	0.8	8.5	1.0	0.00	1.80	2.85	3.19	15.0	NR
UnitedHealth Group UNH	75184.2	60	36	37.9	28.2	670	25	1.7	20.8	1.4	0.03	1.97	2.49	2.92	17.3	A
Universal Health Services UHS	2615.0	48	8	NA	11.4	214	21	0.7	8.9	1.3	0.67	2.76	2.64	2.90	14.0	B+
WellCare Health Plans WCG	1548.6	39	21	NA	16.6	438	26	0.9	23.0	1.4	0.00	1.56	1.64	2.41	16.8	NR
WellChoice WC	6525.0	77	45	NA	14.7	341	23	1.0	20.6	1.5	0.00	2.94	3.43	[illegible]	15.0	NR
WellPoint WLP	47335.0	77	34	29.3	9.4	223	23	1.2	NA	1.3	0.00	3.05	3.99	4.74	15.0	NR
15 PHARMACEUTICALS & BIOTECHNOLOGY																
INDUSTRY GROUP COMPOSITE	**50335.4**	**47**	**11**	**8.1**	**14.3**	**493**	**65**	**5.3**	**24.9**	**2.7**	**1.40**	**1.28**	**2.00**	**2.28**	**13.4**	
(A) BIOTECHNOLOGY																
INDUSTRY COMPOSITE	38735.2	59	29	5.8	11.5	568	124	8.5	35.1	2.1	0.09	0.73	1.75	2.17	17.7	
Amgen AMGN	99867.6	81	26	14.6	17.2	486	29	8.3	22.9	1.7	0.00	1.81	3.21	3.67	15.0	B
Applied Biosystems Group ABI (6)	5182.7	28	32	5.5b	17.4	370	23	2.9	16.1	2.3	0.62	0.83	1.19*	1.16	10.0	B+
Biogen Idec BIIB	14530.1	43	-36	-33.6	2.0	214	113	6.1	27.1	1.9	0.00	0.07	1.57	2.02	14.0	C
Chiron CHIR	8352.5	44	33	36.8	0.8	331	443	5.2	NA	2.8	0.00	0.28	1.06	1.80	15.0	B-
Genentech DNA	100832.4	96	76	NA	14.8	1306	90	16.7	66.5	2.4	0.00	0.73	1.28	1.80	31.5	NR
Genzyme General GENZ	19191.3	74	28	NA	3.6	385	130	7.4	43.4	1.7	0.00	0.37	2.29	2.75	19.5	B
Gilead Sciences GILD	23189.4	51	45	NM	24.5	836	37	13.0	34.5	1.6	0.00	0.99	1.63	2.00	19.0	B-
(B) PHARMACEUTICALS																
INDUSTRY COMPOSITE	57102.1	40	1	9.0	16.0	449	27	3.4	19.3	3.0	2.16	1.60	2.14	2.35	10.8	
Abbott Laboratories ABT	58496.8	38	-19	6.2	23.6	410	18	2.7	12.4	1.5	2.92	2.02	2.50	2.69	10.0	[illegible]
Allergan AGN	13159.3	100	23	22.8	28.1	982	35	5.8	33.6	1.8	0.40	2.82	3.26	3.75	17.0	[illegible]
Bristol-Myers Squibb BMY	42251.6	22	-16	-10.1	23.4	375	16	2.2	13.1	15.4	5.19	1.21	1.40	1.24	1.0	A-
Forest Laboratories FRX (3)	13337.5	39	-13	39.7	22.2	404	19	4.6	17.0	1.4	0.00	2.25	2.32	2.67	12.0	B+
IVAX IVX	8197.7	30	89	8.6	11.2	464	41	3.7	27.9	1.5	0.00	0.75	0.79	1.42	25.0	B-
Johnson & Johnson JNJ	183707.1	62	-3	15.2	25.6	499	20	3.6	15.8	1.8	2.14	2.84	3.49	3.77	10.0	A+
Lilly (Eli) LLY	57399.7	51	-11	-12.2	11.2	504	43	4.0	30.0	1.8	3.01	1.66	2.83	3.08	10.0	B+
Merck MRK	64376.5	29	-9	-1.7	25.9	362	14	2.9	10.4	NM	5.17	2.61	2.51	2.35	-1.3	A+
Pfizer PFE	156273.6	21	-21	27.7	12.3	235	19	3.0	11.4	1.8	3.58	1.49	1.94	2.02	6.0	A
Schering-Plough SGP	28555.0	19	-7	NM	-10.6	485	NM	3.0	NM	2.6	1.14	-0.67	0.36	0.59	20.5	A-
Watson Pharmaceuticals WPI	3696.8	33	2	-6.3	8.4	177	22	2.2	10.4	2.1	0.00	1.27	1.39	1.49	11.5	[illegible]
Wyeth WYE	55774.1	42	-2	NM	10.2	492	49	3.0	30.6	1.7	2.41	0.91	2.95	3.15	8.2	[illegible]
INDUSTRIALS																
SECTOR COMPOSITE	11464.6	44	14	10.7	16.6	835	23	1.0	13.2	1.7	1.18	1.70	2.38	2.94	13.3	
16 CAPITAL GOODS																
INDUSTRY GROUP COMPOSITE	**14227.7**	**48**	**16**	**12.3**	**17.0**	**323**	**23**	**1.0**	**14.2**	**1.8**	**1.27**	**2.02**	**2.78**	**3.32**	**12.7**	
(A) AEROSPACE & DEFENSE																
INDUSTRY COMPOSITE	21352.3	60	14	5.2	18.2	351	20	1.2	13.3	1.5	1.41	2.62	3.39	3.85	11.9	
Alliant Techsystems ATK (3)	2780.8	76	16	17.3	24.2	389	17	0.9	11.3	1.7	0.00	4.03	4.58	5.05	9.5	B+
Boeing BA	52546.8	68	32	-1.4	24.2	558	24	1.0	NA	1.7	1.47	2.24	3.05	3.31	13.0	B+
General Dynamics GD	23002.9	114	9	7.7	17.5	289	17	1.1	13.3	1.4	1.40	5.97	7.21	8.12	11.0	A-
Goodrich GR	4734.7	39	18	-11.2	14.5	317	22	0.9	10.7	1.2	2.08	1.30	2.07	2.34	15.0	[illegible]
Honeywell International HON	30794.4	37	3	-7.7	11.6	271	23	1.1	14.9	1.3	2.26	1.49	2.12	2.41	13.0	[illegible]
L-3 Communications Holdings LLL	8942.4	75	2	29.6	11.1	208	19	1.1	14.9	1.3	0.67	3.33	4.16	4.90	13.6	NR
Lockheed Martin LMT	26425.1	61	9	NM	21.1	342	17	0.7	11.4	1.5	1.98	2.83	3.96	4.26	10.5	B-
Northrop Grumman NOC	20349.1	57	6	-9.3	7.8	120	16	0.7	9.8	1.5	1.81	2.99	3.71	4.25	10.3	B+
Precision Castparts PCP (3)	6761.3	51	55	9.4	15.8	367	24	2.1	18.5	1.6	0.24	1.80	2.49	3.00	12.5	B
Raytheon RTN	17163.1	38	-1	-8.3	8.6	163	19	0.8	12.8	1.6	2.29	0.99	2.05	2.49	12.0	B-
Rockwell Collins COL (9)	7883.3	46	16	19.8a	42.2	810	21	2.3	15.3	1.7	1.05	1.67	2.20*	2.54	12.0	NR
United Technologies UTX	54844.3	54	4	11.7	19.6	348	18	1.3	13.5	1.7	1.63	2.76	3.10	3.49	10.0	A+
(B) BUILDING PRODUCTS																
INDUSTRY COMPOSITE	3509.6	33	14	8.8	20.2	341	18	0.6	12.4	1.2	0.91	1.31	2.06	2.45	13.9	
American Standard ASD	8000.7	38	-8	-0.5	40.3	795	21	0.8	13.8	1.1	1.58	1.42	2.55	2.85	14.0	B-
Builders FirstSource BLDR	650.4	20	NA	28.4	29.5	435	13	0.3	NA	0.4	0.00	1.93	2.22	2.55	20.0	NR
Griffon GFF (9)	744.7	24	-10	13.9b	13.5	206	16	0.5	9.1	NA	0.00	1.71	1.55*	1.98	NA	[illegible]
Jacuzzi Brands JJZ (9)	618.8	8	-7	-0.6c	20.8	220	11	0.5	NA	NM	0.00	0.38	0.40	0.48	NA	B-
Lennox International LII	1902.5	29	44	NM	19.0	300	17	0.6	12.0	1.3	1.37	-1.56	1.79	2.00	12.5	NR
Masco MAS	12686.2	30	-19	14.2	17.1	254	15	1.0	11.5	0.9	2.69	2.04	2.23	2.53	15.0	A-
Universal Forest Products UFPI	1056.1	57	32	14.8	14.4	254	18	0.4	11.2	1.8	0.19	2.59	3.17	3.79	10.0	A
York International YRK	2417.4	56	63	-8.4	7.2	261	36	0.5	16.4	1.8	1.42	1.96	2.60	3.44	12.0	B

Investment Outlook Scoreboard

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
(C) CONSTRUCTION & ENGINEERING																
INDUSTRY COMPOSITE	2857.6	45	58	-1.7	8.0	272	51	0.8	22.6	4.5	0.28	1.17	1.56	2.04	12.3	
Fluor FLR	6432.3	74	36	10.3	13.7	419	30	0.5	20.5	2.4	0.86	2.25	2.48	3.05	12.5	[illegible]
Granite Construction GVA	1547.9	37	40	0.2	11.4	264	23	0.6	11.8	2.0	1.08	1.39	1.53	1.98	12.0	A-
Jacobs Engineering Group JEC (9)	3747.1	65	36	12.4b	13.2	327	25	0.7	20.6	1.7	0.00	2.25	2.57*	2.90	15.0	B+
McDermott International MDR	2952.9	42	128	NM	NM	NM	15	1.5	12.0	1.1	0.00	0.90	1.96	2.10	20.0	C
Quanta Services PWR	1674.6	14	77	NM	1.9	246	118	1.0	23.5	9.9	0.00	-0.08	0.18	0.38	8.0	NR
Shaw Group SGR (8)	2281.1	29	62	-29.8b	1.6	199	116	0.7	50.1	11.6	0.00	-0.41	0.25*	1.37	10.0	[illegible]
Washington Group International WGII	1367.2	52	25	NA	6.5	179	31	0.4	19.5	3.1	0.02	1.86	1.97	2.51	8.5	NR
(D) ELECTRICAL EQUIPMENT																
INDUSTRY COMPOSITE	6757.6	45	12	7.2	15.1	325	22	1.3	14.1	1.7	1.58	1.88	2.18	2.60	12.6	
Acuity Brands AYI (8)	1398.3	31	-2	4.3b	9.6	258	27	0.6	15.0	2.3	1.93	1.56	1.17*	2.10	11.5	NR
American Power Conversion APCC	4376.7	22	5	2.0	11.0	269	25	2.3	19.2	1.5	1.78	0.90	0.90	1.14	16.5	B+
Cooper Industries CBE	6664.7	73	7	-1.5	15.7	278	[illegible]	1.4	13.6	1.8	2.03	3.58	4.08	4.61	10.0	B+
Emerson Electric EMR (9)	31049.4	76	[illegible]	8.6b	19.2	420	22	1.8	15.7	2.2	2.35	2.98	3.40*	4.03	10.0	A
General Cable BGC	721.3	[illegible]	31	NM	15.0	358	[illegible]	0.3	7.0	1.4	0.00	0.75	0.90	1.15	14.0	C
Hubbell HUB.B	2939.8	49	-7	2.8	16.8	307	19	1.4	14.1	1.8	2.72	2.51	2.63	2.91	10.0	B+
Rockwell Automation ROK (9)	10140.5	56	14	43.7b	31.4	615	20	2.0	15.0	1.4	1.59	1.85	2.77*	3.11	14.5	B+
Smith (A.O.) AOS	1095.2	36	22	-9.5	5.7	178	31	0.7	12.5	1.7	1.76	1.18	1.74	2.10	12.0	B-
Thomas & Betts TNB	2432.4	40	30	NM	11.0	239	22	1.5	15.0	1.3	0.00	1.57	1.99	2.29	15.0	B-
(E) INDUSTRIAL CONGLOMERATES																
INDUSTRY COMPOSITE	84971.5	56	9	6.4	16.5	365	31	1.6	14.2	1.5	1.66	2.04	2.95	4.08	13.1	
General Electric GE	377423.4	36	-2	6.1	16.7	334	20	2.3	13.7	1.9	2.80	1.61	1.72	1.98	11.0	A+
Teleflex TFX	2679.0	66	27	-13.9	6.6	236	37	1.1	NA	1.8	1.51	1.69	3.68	4.06	10.0	A
Textron TXT	10444.2	79	7	9.7	5.0	319	67	0.9	19.9	1.7	1.77	2.66	3.98	5.05	12.0	B+
3M MMM	59639.5	78	-4	12.8	30.8	582	19	2.8	14.4	1.5	2.14	3.75	4.26	4.72	12.0	A-
Tyco International TYC (9)	57685.3	29	-20	-8.0b	9.9	178	19	1.5	11.5	1.4	1.40	1.38	1.51*	2.01	13.5	B-
Walter Industries WLT	1957.7	50	49	31.6a	29.9	541	22	1.3	11.5	1.0	0.32	1.14	2.58	6.68	20.0	B
(F) MACHINERY																
INDUSTRY COMPOSITE	7154.9	51	10	21.1	18.2	308	[illegible]	1.1	12.2	1.4	1.23	2.28	3.33	3.92	13.2	
AGCO AG	1532.3	17	-23	131.1	9.5	100	11	0.3	6.1	0.9	0.00	1.71	1.50	1.78	12.0	B-
Briggs & Stratton BGG (6)	1876.6	36	-13	19.3b	13.8	210	15	0.7	9.5	1.2	2.43	2.77	2.25*	3.21	13.0	B+
Caterpillar CAT	39302.4	58	19	17.5	30.5	468	16	1.1	9.8	1.3	1.73	2.88	3.94	4.77	11.0	B+
Crane CR	1907.6	32	10	NM	20.2	262	13	0.9	9.4	1.6	1.57	-1.78	2.24	2.46	9.0	B
Cummins CMI	3996.1	89	6	114.4	28.5	227	9	0.4	5.1	0.6	1.35	7.39	10.81	11.86	14.5	B-
Danaher DHR	17099.5	56	-3	20.0	17.3	342	21	2.2	NA	1.3	0.14	2.30	2.76	3.11	15.0	A
Deere DE (10)	16726.7	69	-7	NM	21.1	244	12	0.8	NA	1.6	2.25	5.56	5.87*	6.27	7.5	[illegible]
Donaldson DCI (7)	2777.5	33	3	11.2b	23.0	553	25	1.7	17.4	2.0	0.96	1.18	1.27*	1.52	13.0	A+
Dover DOV	8197.9	40	-4	-4.8	13.8	251	18	1.4	NA	1.2	1.68	2.00	2.34	2.83	14.0	A-
Eaton ETN	9430.6	64	-12	13.4	21.1	255	13	0.9	8.0	1.1	1.95	4.13	5.32	6.09	11.0	B+
Harsco HSC	2773.6	66	19	3.7	14.6	289	20	1.0	8.3	1.3	1.96	2.73	3.33	3.80	15.5	B+
Illinois Tool Works ITW	24760.0	[illegible]	-5	8.4	20.0	340	18	2.0	13.6	1.4	1.50	4.39	5.17	5.73	12.5	A+
Ingersoll-Rand IR	13111.0	40	-1	17.9	17.9	234	14	1.3	NA	1.1	1.44	2.37	2.99	3.39	12.0	A
ITT Industries ITT	10043.6	109	29	12.2	21.9	405	19	1.3	13.2	1.7	0.66	4.63	5.26	5.94	12.0	B+
JLG Industries JLG (7)	2350.9	46	132	10.7b	18.5	464	24	1.2	19.3	2.5	0.04	0.61	1.20*	2.39	15.0	B+
Joy Global JOYG (10)	4291.9	53	83	NM	21.0	813	39	2.4	28.6	1.3	0.85	0.69	1.98	2.73	20.0	NR
Kennametal KMT (6)	2107.2	55	10	15.6b	12.4	209	17	0.9	10.9	NA	1.39	2.02	3.13*	3.81	NA	[illegible]
Manitowoc MTW	1515.6	50	33	-10.1	10.6	284	27	0.7	NA	1.4	0.56	1.45	2.35	3.49	15.0	[illegible]
Mueller Industries MLI	991.7	27	-16	-3.1	17.4	250	15	0.6	9.0	NA	1.48	2.15	1.98	2.43	NA	B
Navistar International NAV (10)	1988.7	28	-35	5.1c	42.7	291	[illegible]	0.2	NA	0.3	0.00	3.20	4.84	5.61	17.5	C
Oshkosh Truck OSK (9)	3296.8	45	31	30.6b	19.6	403	21	1.1	17.2	1.1	0.60	1.57	2.18*	2.70	18.5	A
Paccar PCAR	12160.8	72	-11	19.3	26.4	302	12	0.9	8.6	0.8	1.39	5.16	6.92	7.71	12.5	B+
Pall PLL (7)	3451.7	28	-4	4.2b	12.5	299	24	1.8	14.9	2.5	1.44	1.20	1.12*	1.40	10.0	[illegible]
Parker Hannifin PH (6)	8193.1	[illegible]	-10	11.3b	16.1	234	15	1.0	NA	1.4	1.34	2.82	4.55*	5.16	11.0	A-
Pentair PNR	3892.0	38	-12	11.9	12.2	252	21	1.4	15.2	1.3	1.36	1.35	1.92	2.22	15.0	A-
SPX SPW	3098.3	47	[illegible]	NM	-5.5	121	NM	0.7	NA	2.3	2.12	-1.54	2.57	2.81	8.0	B-
Timken TKR	2864.1	31	19	18.3	16.4	204	12	0.6	6.5	0.5	1.94	1.49	2.62	2.87	23.0	B-
Toro TTC (10)	1714.2	40	-1	28.4b	29.2	440	16	1.0	NA	1.4	0.90	2.02	2.45*	2.83	12.0	A-
Trinity Industries TRN	2040.4	42	22	NM	4.8	187	38	0.7	14.1	3.1	0.67	-0.27	1.65	2.70	8.0	B-
(G) TRADING COMPANIES & DISTRIBUTORS																
INDUSTRY COMPOSITE	2181.5	35	12	16.9	17.1	317	19	0.5	14.2	1.5	2.01	1.64	2.00	2.38	11.1	
Applied Industrial Technologies AIT (6)	955.4	32	17	17.6b	14.7	238	17	0.5	12.6	1.8	1.88	1.07	1.80*	2.14	10.0	B+
BlueLinx Holdings BXC	337.3	11	-23	NA	13.5	197	17	0.1	8.0	1.4	4.48	NA	1.05	1.27	7.5	NR
Grainger (W.W.) GWW	6281.1	70	5	11.2	15.2	286	19	1.2	14.9	1.9	1.37	3.13	3.67	4.21	10.0	A-
Hughes Supply HUG (1)	2583.4	39	20	18.5	10.2	[illegible]	19	0.5	15.0	1.3	0.93	1.95	2.14	2.48	14.0	A-
UAP Holding UAPH (2)	958.0	19	10	NA	30.6	541	18	0.4	13.9	1.6	3.42	0.58	1.21	1.36	10.0	NR
WESCO International WCC	1973.7	42	41	20.4	18.4	449	25	0.5	20.5	1.3	0.00	1.47	2.15	2.83	15.0	NR

Investment Outlook Scoreboard

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE: 2004 ACTUAL	ESTIMATES FROM ANALYSTS: 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
17 COMMERCIAL SERVICES & SUPPLIES																
INDUSTRY GROUP COMPOSITE	**4957.1**	**34**	**3**	**0.8**	**15.1**	**3197**	**24**	**1.0**	**11.8**	**1.7**	**1.38**	**1.48**	**1.79**	**2.04**	**13.2**	
ABM Industries ABM (10)	1049.4	22	9	–7.1c	9.2	222	25	0.4	NA	1.9	1.95	0.61	0.98	1.17	11.5	A
Allied Waste Industries AW	2781.2	8	–9	8.3	3.0	112	27	0.5	4.0	2.2	0.00	0.11	0.35	0.44	11.0	C
Aramark RMK (9)	4716.6	26	–2	14.2b	21.8	356	17	0.4	7.8	1.4	1.08	1.36	1.53*	1.63	12.0	NR
Avery Dennison AVY	5893.2	59	–2	0.1	19.8	367	19	1.1	12.5	1.5	2.65	2.78	3.26	3.49	12.0	A
Banta BN	1210.9	51	13	3.2	13.1	230	18	0.8	9.6	2.9	1.43	2.67	2.93	3.19	6.0	B
Brink's BCO	2709.6	46	17	NM	13.0	354	26	0.5	9.5	1.5	0.22	1.82	2.07	2.53	15.0	B
Cendant CD	18203.2	18	–24	22.5	11.3	162	15	1.0	5.3	1.0	2.48	1.71	1.31	1.49	13.0	B
Cintas CTAS (5)	7523.4	45	2	7.6	14.7	359	25	2.4	17.6	1.5	0.72	1.74	1.97	2.24	15.0	A+
Donnelley (R.R.) RRD	7431.7	34	–3	–12.7	12.2	188	16	0.9	8.3	1.4	3.04	1.30	2.27	2.52	10.8	B
Dun & Bradstreet DNB	4315.3	65	9	35.1	NM	63460	22	3.0	17.6	1.3	0.00	2.90	3.48	3.91	14.5	NR
HNI HNI	2760.9	50	17	2.7	18.3	387	22	1.2	14.0	1.4	1.23	1.97	2.47	2.88	15.0	A–
IKON Office Solutions IKN (9)	1349.1	10	–13	52.4b	5.0	55	19	0.3	8.5	2.3	1.59	0.58	0.54*	0.73	8.0	B–
Kelly Services KELYA	994.9	28	–8	–28.9	5.1	150	30	0.2	12.9	1.8	1.44	0.62	1.04	1.61	15.0	A–
Manpower MAN	4056.1	46	–4	17.7a	11.4	192	18	0.3	12.2	1.1	1.16	2.59	2.74	3.08	15.0	B+
Miller (Herman) MLHR (5)	2128.6	31	11	–15.2	43.7	1202	28	1.3	17.5	1.2	0.95	0.96	1.44	1.70	18.0	B+
Pitney Bowes PBI	9503.3	42	–10	–1.5	37.6	694	19	1.8	11.2	1.9	2.98	2.05	2.70	2.82	8.0	A–
Republic Services RSG	5011.6	36	7	5.0	15.4	308	21	1.8	9.6	1.9	1.56	1.53	1.74	1.93	11.0	NR
Robert Half International RHI	6478.2	38	30	–5.7	24.4	708	30	2.0	23.8	1.4	0.73	0.79	1.36	1.54	20.0	B
Spherion SFN	586.8	10	17	–31.2	5.2	133	27	0.3	12.9	1.8	0.00	0.24	0.28	0.44	20.0	C
Steelcase SCS (2)	2204.1	15	7	–50.0	2.6	184	67	0.8	14.1	1.9	2.43	0.08	0.48	0.70	16.5	NR
United Stationers USTR	1590.1	49	6	0.0	12.1	207	18	0.4	12.9	1.3	0.00	2.65	2.96	3.32	12.8	B
Waste Management WMI	16557.2	30	0	NM	19.0	271	15	1.3	6.6	1.8	2.67	1.60	1.49	1.64	11.0	B
18 TRANSPORTATION																
INDUSTRY GROUP COMPOSITE	**8978.8**	**41**	**16**	**15.6**	**16.4**	**352**	**20**	**1.0**	**11.9**	**1.3**	**0.77**	**0.97**	**1.74**	**2.59**	**15.3**	
(A) AIR FREIGHT & LOGISTICS																
INDUSTRY COMPOSITE	15210.6	52	22	22.3	17.6	447	26	1.0	18.2	1.7	0.83	2.04	2.44	2.82	15.2	
Atlas Air Worldwide Holdings AAWW	680.5	35	44	NA	22.6	209	10	0.4	5.4	NA	0.00	NA	2.54	3.19	NA	B
EGL EAGL	1757.5	37	24	NM	10.5	355	36	0.6	20.0	1.6	0.00	1.05	1.16	1.60	20.0	B–
Expeditors Intl. of Washington EXPD	7576.0	71	27	16.7	20.6	859	44	2.0	35.8	2.3	0.42	1.41	1.74	2.05	18.0	A+
FedEx FDX (5)	29582.7	98	–1	24.1	14.7	298	21	1.0	10.1	1.2	0.33	4.72	5.54	6.16	15.0	B+
Hub Group HUBG	819.2	41	55	51.4	12.9	355	28	0.5	20.5	2.2	0.00	0.92	1.52	1.74	12.0	B–
Pacer International PACR	988.6	26	24	19.9	16.3	340	21	0.5	18.1	1.2	2.27	1.24	1.46	1.69	15.3	NR
Robinson (C.H.) Worldwide CHRW	6922.2	41	46	18.4	24.5	923	38	1.3	34.5	2.4	1.28	0.80	1.13	1.30	15.0	A–
Ryder System R	2722.9	42	–11	21.8	14.3	168	12	0.5	2.8	1.0	1.51	3.28	3.41	3.79	12.7	B
United Parcel Service UPS	85845.8	78	–9	4.0	22.2	517	24	2.1	16.2	1.6	1.69	2.93	3.46	3.91	14.0	NR
(B) AIRLINES																
INDUSTRY COMPOSITE	3476.8	21	26	–16.7	16.1	328	16	0.6	6.4	1.1	0.02	–2.52	–1.28	1.15	17.8	
Alaska Air Group ALK	972.5	35	5	NM	10.4	139	18	0.3	4.3	1.1	0.00	–0.57	1.62	3.81	20.0	C
AMR AMR	2788.0	17	54	NM	NM	NM	NM	0.1	5.0	NM	0.00	–4.74	–4.17	0.04	NA	C
Continental Airlines CAL	1044.0	16	15	NM	NM	773	NM	0.1	6.4	NM	0.00	–6.25	–2.96	0.83	NA	C
ExpressJet Holdings XJT	471.4	9	–32	NM	58.2	257	5	0.3	3.6	0.3	0.00	2.04	1.66	1.78	16.0	NR
Southwest Airlines LUV	13080.0	17	1	–16.7	7.7	194	26	1.8	12.7	1.8	0.11	0.38	0.61	0.69	15.0	A–
US Airways Group LCC	2505.3	34	111	NM	–12.1	276	NM	0.8	NM	NM	0.00	–5.99	–4.44	–0.27	20.0	C
(C) MARINE																
INDUSTRY COMPOSITE	2195.3	50	18	6.4	11.7	221	19	1.4	11.0	1.8	1.80	2.29	2.75	2.77	10.0	
Alexander & Baldwin ALEX	2195.3	50	18	6.4	11.7	221	19	1.4	11.0	1.8	1.80	2.29	2.75	2.77	10.0	B+
(D) ROAD & RAIL																
INDUSTRY COMPOSITE	7621.2	42	7	15.0	16.1	302	17	1.1	9.4	1.1	1.00	1.89	2.63	3.11	14.8	
Arkansas Best ABFS	1040.9	41	–8	–1.9	18.8	198	11	0.6	6.6	0.9	1.45	2.94	3.60	3.66	12.9	B
Burlington Northern Santa Fe BNI	24695.2	66	40	–2.9	14.4	245	17	2.0	9.8	1.2	1.21	2.10	4.03	4.56	14.0	A–
CNF CNF	2974.8	57	14	4.7	23.4	357	15	0.7	9.1	1.0	0.70	2.57	3.87	4.27	15.0	B–
CSX CSX	10566.5	49	21	32.3	8.3	136	17	1.2	NA	0.8	1.07	1.87	3.21	3.65	13.5	B–
Hunt (J.B.) Transport Services JBHT	3462.8	22	0	36.1	20.5	439	23	1.1	10.8	1.1	1.07	0.88	1.31	1.45	16.1	B
Laidlaw International LI (8)	2166.3	22	1	NM	–0.4	135	NM	0.7	8.9	NM	2.78	0.45	–0.06*	1.24	NA	B–
Landstar System LSTR	2514.1	43	17	16.5	50.4	1248	26	1.1	21.4	1.6	0.23	1.16	1.90	1.86	13.8	B+
Norfolk Southern NSC	17980.0	44	22	50.5	13.3	202	15	2.2	9.2	1.1	1.18	2.31	2.70	3.10	15.5	B
Swift Transportation SWFT	1427.2	20	–9	12.0	11.9	172	15	0.5	4.9	1.2	0.00	1.29	1.35	1.54	12.0	B+
Union Pacific UNP	20263.7	77	14	–8.1	6.1	152	25	1.5	10.3	1.4	1.57	2.30	3.29	4.64	17.0	B
Werner Enterprises WERN	1626.6	20	–9	15.4	11.4	195	17	0.9	6.4	1.3	0.78	1.08	1.18	1.32	13.3	A
Yellow Roadway YELL	2736.3	47	–15	10.8	14.5	144	9	0.3	5.5	0.6	0.00	3.75	5.23	6.03	15.0	B–

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
INFORMATION TECHNOLOGY SECTOR COMPOSITE	20248.7	32	4	7.3	15.4	395	33	2.7	19.1	1.9	0.26	0.97	1.20	1.52	15.0	
9 SOFTWARE & SERVICES																
INDUSTRY GROUP COMPOSITE	**26742.4**	**45**	**4**	**17.1**	**19.2**	**467**	**34**	**4.0**	**22.2**	**1.9**	**0.31**	**1.16**	**1.55**	**1.80**	**14.0**	
(A) INTERNET SOFTWARE & SERVICES																
INDUSTRY COMPOSITE	58544.0	152	39	76.3	22.1	799	46	11.7	38.0	2.5	0.00	0.91	2.50	3.36	18.4	
EarthLink ELNK	1489.0	11	-1	NM	30.4	304	11	1.1	7.3	NM	0.00	0.70	1.02	0.79	-0.5	C
Google GOOG	117511.6	405	110	NM	14.8	1336	90	22.4	77.8	2.3	0.00	1.46	5.88	8.53	30.0	NR
Yahoo YHOO	56631.4	40	7	76.3	21.2	756	38	11.7	28.9	2.6	0.00	0.58	0.60	0.75	25.7	B-
(B) IT SERVICES																
INDUSTRY COMPOSITE	9038.7	35	0	9.0	21.0	397	25	2.0	14.1	1.8	0.42	1.40	1.60	1.80	13.5	
Accenture ACN (8)	16223.3	28	5	40.7a	55.4	956	18	0.9	13.3	1.4	1.05	1.22	1.56*	1.52	13.0	NR
Affiliated Computer Services ACS (6)	6932.6	56	-7	26.9b	14.1	235	17	1.5	10.5	1.2	0.00	3.83	3.19*	3.41	15.0	B+
Automatic Data Processing ADP (6)	27076.7	47	6	5.6b	18.6	473	26	3.1	19.7	2.2	1.57	1.56	1.79*	1.94	12.0	A+
CACI International CAI (6)	1667.6	55	-19	32.7b	13.0	256	20	1.0	14.4	1.1	0.00	2.13	2.79*	2.91	18.5	B+
Computer Sciences CSC (3)	9291.6	50	-11	15.6	8.0	148	19	0.6	5.9	1.4	0.00	2.59	3.24	3.58	11.0	B+
Convergys CVG	2319.0	17	11	-8.3	8.8	171	20	0.9	9.5	1.5	0.00	0.77	1.02	1.11	11.0	NR
DST Systems DST	4293.7	59	14	11.6	101.7	991	11	1.7	7.2	1.8	0.00	2.59	2.73	3.05	12.0	B
Electronic Data Systems EDS	12006.7	23	0	NM	2.7	162	61	0.6	11.1	4.5	0.87	-0.59	0.58	0.99	8.8	B
First Data FDC	33123.2	43	2	18.7	20.2	404	21	3.2	13.7	1.5	0.55	2.22	2.28	2.56	13.0	A
Fiserv FISV	8446.3	46	13	NA	18.5	338	19	2.1	13.2	1.3	0.00	2.00	2.30	2.55	15.2	B+
Hewitt Associates HEW (9)	2777.0	26	-20	NA	10.3	212	22	1.0	11.4	1.7	0.00	1.25	1.19*	1.32	13.0	NR
Iron Mountain IRM	5409.1	41	35	NM	8.6	407	48	2.7	18.4	2.4	0.00	0.72	0.86	1.05	20.0	B-
MPS Group MPS	1270.6	13	3	-27 3	6.0	150	26	0.8	19.0	1.4	0.00	0.33	0.53	0.65	17.5	B-
Paychex PAYX (5)	16072.9	42	24	9.3	27.2	1102	41	10.7	34.9	2.2	1.51	0.97	1.21	1.38	16.0	A+
Perot Systems PER	1647.9	14	-13	12.3	11.8	174	15	0.9	9.8	1.1	0.00	0.78	0.86	0.99	15.0	B
Sabre Holdings TSG	3001.1	23	3	16.9	10.8	178	16	1.3	NA	1.6	1.57	1.38	1.47	1.60	10.0	B
Unisys UIS	2098.8	6	-40	-37.3	NM	NM	NM	0.4	NM	NM	0.00	0.11	-0.34	0.04	8.0	B-
(C) SOFTWARE																
INDUSTRY COMPOSITE	49582.2	29	0	24.7	14.9	481	47	5.3	32.8	1.9	0.19	0.78	1.12	1.29	13.6	
Activision ATVI (3)	3639.4	13	17	40.4	7.5	325	44	2.7	37.8	1.3	0.00	0.50	0.54	0.63	19.0	B-
Adobe Systems ADBE (11)	16090.1	33	4	12.7	26.9	774	30	8.5	25.7	1.9	0.00	0.91	1.13	1.22	15.0	B+
BMC Software BMC (3)	4432.0	20	10	18.9	4.6	384	82	3.0	NA	2.3	0.00	0.34	1.01	1.09	8.7	C
Computer Associates International CA (3)	16560.1	29	-8	NM	3.7	339	92	4.5	53.4	3.0	0.56	-0.01	0.95	1.17	10.0	B-
Electronic Arts ERTS (3)	16908.0	56	-9	NA	12.6	567	47	5.6	36.5	2.0	0.00	1.59	1.51	1.83	18.3	B+
Intuit INTU (7)	9407.2	54	22	NM	25.1	627	27	4.5	NA	1.8	0.00	1.61	1.99*	2.31	15.0	B-
Microsoft MSFT (6)	294653.6	28	4	12.9b	26.6	610	23	7.3	21.4	2.2	1.16	0.75	1.12*	1.32	11.0	B+
Oracle ORCL (5)	64877.4	13	-8	5.7	25.6	573	23	5.3	18.8	1.6	0.00	0.55	0.80	0.91	10.0	B
Symantec SYMC (3)	19671.7	18	-32	57.6	1.5	130	53	6.2	35.6	1.2	0.00	0.74	1.00	1.15	15.0	B
20 SEMICONDUCTORS & SEMICONDUCTOR EQUIPMENT																
INDUSTRY GROUP COMPOSITE	**17631.4**	**25**	**14**	**0.1**	**6.3**	**361**	**48**	**3.3**	**19.9**	**2.3**	**0.35**	**0.60**	**0.85**	**1.14**	**16.3**	
Advanced Micro Devices AMD	10523.4	26	19	-46.0	1.3	354	291	2.0	8.0	4.4	0.00	0.25	0.40	0.80	15.0	C
Agere Systems AGR (9)	2390.7	13	-4	NM	-1.9	560	NM	1.4	NA	NM	0.00	-0.52	-0.04*	0.52	12.5	NR
Amkor Technology AMKR	1095.6	6	-7	NM	NM	638	NM	0.6	57.9	NM	0.00	-0.21	-0.79	0.09	15.0	C
Analog Devices ADI (10)	13910.3	38	3	3.8b	11.2	377	35	5.8	24.4	2.3	1.27	1.45	1.08*	1.65	15.0	B
Applied Materials AMAT (10)	29383.3	18	6	12.2b	13.5	327	25	4.2	NA	1.7	0.66	0.78	0.73*	0.77	15.0	B-
Atmel ATML	1618.7	3	-15	NM	-10.5	181	NM	1.0	7.8	NM	0.00	-0.01	-0.20	0.07	NA	C
Broadcom BRCM	16016.0	47	44	NM	10.1	563	60	6.7	46.0	1.3	0.00	0.63	1.40	1.73	25.0	C
Fairchild Semiconductor Intl. FCS	2078.3	17	7	-35.0	-21.9	206	NM	1.5	NM	10.3	0.00	0.48	0.13	0.69	13.5	NR
Freescale Semiconductor FSL.B	10578.0	26	41	NA	8.6	243	29	1.8	9.8	1.6	0.00	1.06	1.26	1.54	12.5	NR
Intel INTC	160827.0	27	14	-6.4	22.7	439	20	4.2	12.3	1.2	1.20	1.16	1.43	1.62	15.5	A
KLA-Tencor KLAC (6)	10105.5	51	10	4.7b	13.5	319	24	4.9	20.4	1.3	0.94	1.21	2.32*	2.01	16.5	B
Lam Research LRCX (6)	4733.6	38	30	18.4b	24.5	447	21	3.4	16.7	1.0	0.00	0.59	2.10*	1.63	17.5	B-
LSI Logic LSI	3214.7	8	50	NM	-15.2	203	NM	1.8	NM	1.3	0.00	-1.21	0.41	0.52	15.0	C
Maxim Integrated Products MXIM (6)	11975.1	37	-14	14.2b	18.6	444	25	7.2	20.6	1.2	1.37	1.20	1.58*	1.67	20.0	B+
Micron Technology MU (8)	8787.0	14	15	NM	3.2	150	49	1.8	6.1	3.3	0.00	0.24	0.29*	0.54	15.0	B-
National Semiconductor NSM (5)	8894.2	26	44	14.3	NA	451	25	4.8	15.6	1.7	0.46	1.11	1.11	1.35	13.5	B-
Novellus Systems NVLS	3290.4	25	-12	-10.6	6.6	174	27	2.4	15.5	2.0	0.00	1.06	0.82	1.01	15.0	B-
NVIDIA NVDA (1)	6188.0	36	53	-2.1	18.7	459	26	2.7	17.3	1.1	0.00	0.57	1.66	2.05	20.0	B-
Teradyne TER	2880.2	15	-14	-26.4	-12.6	280	NM	2.1	NM	NM	0.00	0.84	-0.14	0.79	15.7	C
Texas Instruments TXN	52554.3	32	32	-11.7	18.2	443	25	4.1	14.4	1.2	0.37	1.05	1.39	1.69	20.0	B
Xilinx XLNX (3)	9214.9	26	-11	71.7	10.6	333	33	5.9	25.9	1.5	1.06	0.87	0.95	1.15	19.0	B
21 TECHNOLOGY HARDWARE & EQUIPMENT																
INDUSTRY GROUP COMPOSITE	**17470.4**	**27**	**0**	**4.3**	**16.9**	**367**	**28**	**1.7**	**17.1**	**1.8**	**0.19**	**1.02**	**1.15**	**1.51**	**15.1**	
(A) COMMUNICATIONS EQUIPMENT																
INDUSTRY COMPOSITE	27888.4	22	4	12.4	35.3	567	25	3.2	19.6	1.9	0.21	0.53	0.58	1.02	15.0	
Andrew ANDW (9)	1758.9	11	-20	-27.9b	2.4	113	48	0.9	14.4	4.8	0.00	0.20	0.23*	0.47	10.0	B
Avaya AV (9)	5615.8	12	-31	NM	47.1	286	5	1.1	NA	0.6	0.00	0.63	1.89*	0.61	10.0	NR

Investment Outlook Scoreboard

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG TERM GROWTH RATE %	S&P EQUITY RANKING
Cisco Systems CSCO (7)	107941.2	18	−9	NM	26.2	504	20	4.3	16.4	1.3	0.00	0.70	0.87*	1.03	15.0	B+
Corning GLW	30739.5	20	72	NM	14.9	525	39	7.0	23.6	1.2	0.00	−1.57	0.85	1.02	20.5	C
Harris HRS (6)	5919.2	45	44	66.5b	14.2	306	29	1.9	21.0	2.0	0.72	0.92	1.46*	2.05	15.0	B
Lucent Technologies LU (9)	12407.1	3	−26	NM	260.3	2721	12	1.3	NA	1.8	0.00	0.42	0.24*	0.18	6.5	B−
Motorola MOT	60003.4	24	40	13.6	25.8	381	15	1.7	NA	1.8	0.66	0.90	1.12	1.28	12.0	B+
Qualcomm QCOM (9)	74570.8	45	7	NM	19.3	671	36	13.1	31.9	1.8	0.79	1.03	1.26*	1.48	20.0	B
Scientific-Atlanta SFA (6)	6498.7	42	35	−9.1b	10.4	314	30	3.3	23.9	2.1	0.09	1.41	1.36*	1.50	15.0	A−
Superior Essex SPSX	323.0	19	0	NM	15.8	158	10	0.2	5.7	1.4	0.00	0.63	1.39	1.72	10.0	NR
UTStarcom UTSI	994.9	8	−63	18.9	−47.8	101	NM	0.3	NM	NM	0.00	0.56	−4.26	−0.44	31.0	NR
(B) COMPUTERS & PERIPHERALS																
INDUSTRY COMPOSITE	29951.4	32	5	13.7	18.0	440	27	1.9	17.3	1.6	0.27	1.19	1.42	1.68	14.3	
Apple Computer AAPL (9)	56631.0	50	111	NM	17.9	759	43	4.1	38.1	2.1	0.00	0.36	1.56*	1.82	21.0	B
Dell DELL (1)	71789.5	30	−28	9.9	66.9	1489	23	1.3	19.9	1.3	0.00	1.18	1.55	1.77	15.2	B+
Diebold DBD	2725.1	39	−30	7.1	11.1	224	21	1.1	12.8	1.4	2.11	2.53	1.91	2.21	14.5	A
EMC EMC	33302.3	14	−6	−17.8	10.7	274	26	3.6	17.1	1.4	0.00	0.36	0.53	0.65	18.5	B
Gateway GTW	1128.4	3	−49	NM	7.7	414	61	0.3	16.4	2.2	0.00	−1.45	0.14	0.16	10.0	C
Hewlett-Packard HPQ (10)	85093.6	30	41	23.7b	6.5	229	36	1.0	17.9	3.0	1.08	1.15	0.82*	1.82	12.0	A−
International Business Machines IBM	140419.0	89	−10	3.4	25.9	464	19	1.5	11.8	1.6	0.90	4.94	5.16	5.66	11.0	A−
Lexmark International LXK	5523.9	48	−44	19.1	27.6	355	14	1.0	9.6	1.5	0.00	4.28	3.15	2.86	10.0	B+
Maxtor MXO	1031.3	4	−23	NM	−17.5	184	NM	0.3	17.5	NM	0.00	−0.73	−0.08	0.01	10.0	NR
NCR NCR	6236.6	34	−2	13.5	22.8	280	13	1.0	8.1	2.0	0.00	1.51	1.58	1.90	11.0	B−
Network Appliance NTAP (4)	10835.7	29	−12	29.5	13.8	558	44	6.0	33.3	1.5	0.00	0.59	0.79	0.88	25.0	B
SanDisk SNDK	9400.9	51	104	−8.6	14.6	416	30	4.5	24.1	1.3	0.00	1.44	1.92	2.31	20.0	B
Seagate Technology STX (6)	9081.6	19	10	57.6a	32.7	321	10	1.1	6.4	1.0	0.00	1.06	1.41*	1.85	13.0	NR
Sun Microsystems SUNW (6)	12871.7	4	−30	NM	−1.5	193	NM	1.2	18.6	NM	0.00	−0.12	−0.03*	−0.06	8.5	C
Western Digital WDC (6)	3200.3	15	38	NM	30.5	412	14	0.8	8.5	1.1	0.00	0.70	0.91*	1.22	15.0	B−
(C) ELECTRONIC EQUIPMENT & INSTRUMENTS																
INDUSTRY COMPOSITE	3281.0	27	−5	−4.2	6.8	219	31	0.8	16.4	1.8	0.13	1.17	1.26	1.67	15.8	
Agilent Technologies A (10)	18293.6	36	48	−29.3c	3.5	448	127	3.6	35.3	9.1	0.00	0.37	0.28*	1.49	14.0	NR
Agilysys AGYS (3)	580.3	19	11	NM	5.4	160	29	0.3	24.5	1.1	0.63	0.69	1.12	1.25	15.0	B+
Amphenol APH	3712.4	42	14	9.6	31.0	506	19	2.2	15.3	0.9	0.29	1.82	2.27	2.61	20.0	B+
Anixter International AXE	1400.2	37	2	−1.6	13.9	204	15	0.4	12.1	1.0	0.00	1.90	2.33	2.71	16.0	B
Arrow Electronics ARW	3703.7	31	28	−16.3	9.9	162	16	0.3	13.4	1.1	0.00	1.75	2.13	2.47	12.8	B−
Avnet AVT (6)	3282.4	23	23	NM	6.1	128	18	0.3	14.9	1.1	0.00	0.60	1.39*	1.62	15.0	B−
Bell Microproducts BELM	256.7	8	−11	−21.4	6.8	111	16	0.1	9.5	0.9	0.00	0.40	0.48	0.64	20.0	C
Benchmark Electronics BHE	1283.4	31	−10	23.8	9.3	157	17	0.6	12.5	0.8	0.00	1.67	1.83	2.11	20.0	B
CDW CDWC	4726.2	59	−12	11.7	21.5	385	19	0.8	16.6	1.1	0.73	2.79	3.24	3.48	17.0	B+
Ingram Micro IM	3023.7	19	−10	−2.2	9.0	129	15	0.1	11.0	0.9	0.00	1.38	1.44	1.58	15.0	B−
Jabil Circuit JBL (8)	6772.8	33	29	17.4b	10.9	317	30	0.9	15.0	1.2	0.00	0.81	1.12*	1.61	25.0	B
Mettler-Toledo International MTD	2372.1	57	11	9.3	15.4	361	25	1.6	18.6	1.6	0.00	2.37	2.81	3.17	13.0	NR
Molex MOLX (6)	4994.4	27	−11	−5.8b	6.9	231	34	1.9	13.3	2.2	0.75	0.92	0.81*	1.20	15.0	B+
PC Connection PCCC	160.4	5	−33	−27.9	3.8	94	24	0.1	11.8	2.8	0.00	0.33	0.27	0.42	8.5	NR
Sanmina-SCI SANM (9)	2176.1	4	−51	NM	−41.9	91	NM	0.2	NA	NM	0.00	−0.03	−1.91*	0.30	17.5	C
ScanSource SCSC (6)	751.5	59	−5	19.7b	15.3	318	21	0.5	18.0	1.3	0.00	2.31	2.75*	3.06	16.0	B+
Solectron SLR (8)	3438.9	4	−33	NM	−0.4	141	NM	0.3	18.8	NM	0.00	−0.30	−0.01*	0.18	15.0	C
Symbol Technologies SBL	2882.7	11	−34	NM	3.1	244	76	1.6	27.8	2.6	0.17	0.33	0.24	0.44	18.5	B−
SYNNEX SNX (11)	451.6	16	−35	−2.6	10.1	108	11	0.1	8.8	1.0	NA	1.55	1.35	1.49	11.8	NR
Tech Data TECD (1)	2275.0	39	−13	−3.3	3.3	132	42	0.1	18.1	1.3	0.00	2.74	2.04	2.60	15.0	B−
Vishay Intertechnology VSH	2362.2	13	−15	−48.3	−0.7	81	NM	1.1	13.2	2.1	0.00	0.27	0.49	0.75	12.5	B−
(D) OFFICE ELECTRONICS																
INDUSTRY COMPOSITE	13637.7	14	−17		11.2	208	17	0.9	8.8	1.4	0.00	0.78	0.90	1.04	11.0	
Xerox XRX	13637.7	14	−17	NM	11.2	208	17	0.9	8.8	1.4	0.00	0.78	0.90	1.04	11.0	B
MATERIALS																
SECTOR COMPOSITE	5815.9	38	0	18.3	17.0	368	26	1.0	9.5	2.0	1.63	2.09	2.93	2.81	11.1	
22 MATERIALS																
INDUSTRY GROUP COMPOSITE	**5815.9**	**38**	**0**	**18.3**	**17.0**	**368**	**26**	**1.0**	**9.5**	**2.0**	**1.63**	**2.09**	**2.93**	**2.81**	**11.1**	
(A) CHEMICALS																
INDUSTRY COMPOSITE	6432.6	34	−6	12.8	18.6	417	32	1.0	9.8	2.1	1.57	1.50	2.79	2.65	8.9	
Air Products & Chemicals APD (9)	13129.8	59	2	9.8b	15.6	287	19	1.6	9.1	1.9	2.16	2.64	3.08*	3.41	10.0	B+
Airgas ARG (3)	2390.4	31	17	30.0	12.0	270	23	0.9	10.5	1.8	0.77	1.20	1.55	1.78	11.0	B+
Albemarle ALB	1715.7	37	−5	−12.3	11.3	189	17	0.9	7.9	1.7	1.74	1.29	2.14	2.54	10.0	B+
Ashland ASH (9)	4136.7	56	−5	48.1b	53.4	111	2	0.4	1.9	0.2	1.97	5.59	26.62*	3.08	9.0	B
Cabot CBT (9)	2175.2	35	−9	NM	−4.0	200	NM	1.0	12.9	NM	1.83	1.79	−0.73*	1.92	12.5	B−
Celanese CE	2743.1	17	NA	NA	64.4	4649	346	0.5	NA	1.6	0.92	NA	2.03	2.28	5.3	NR
Chemtura CEM	2890.8	12	2	NM	−7.7	150	NM	1.1	NM	1.9	1.66	−0.32	0.63	0.99	10.0	B−
Cytec Industries CYT	2088.0	45	−12	−9.0	6.9	171	23	0.8	9.6	1.8	0.88	2.84	3.07	3.69	8.0	B
Dow Chemical DOW	43671.8	45	−9	12.2	30.3	598	10	1.0	6.9	1.3	2.96	2.93	4.39	5.40	6.0	B
DuPont DD	42536.7	43	−13	−5.2	18.0	361	20	1.6	12.0	1.8	3.46	1.77	2.44	2.90	10.0	B

larket Volatility — Friend or Foe?

ng Index Options to Profit From Market Volatility

ince the introduction of formal analytics such he Nobel Prize-winning Black-Scholes Model, estors have used options as tools to reduce risk enhance investment performance. Moreover, ck-Scholes and intellectual successors have ved out a role for volatility as an investment l. Much like a stock price is driven by the nings of a company, option prices are driven by volatility of the underlying assets.

ndex options can be used as a vehicle to extract h flow from volatility. Since index options are h-settled, they minimize turnover associated with the underlying portfolio and thereby reduce transaction costs. Second, index options are highly liquid instruments since they are traded in and tied to the vast index-investing market.

The investment approach is straightforward. Index call options are sold, with the investor advised to secure the call option positions with an underlying stock portfolio reasonably correlated to the index options sold. The premiums received from the sale provide a generous cash flow and, in theory, any obligations created by a subsequent upward move in the index can be offset by a gain in the underlying diversified basket of stocks.

The risk associated with this approach is the downside exposure in the underlying stocks. First, a loss in the stock portfolio can exceed the profit from the call premiums received. Furthermore, the base against which index call options can be sold may be severely diminished. With the upside limited, the break-even point may be a long time away. To manage the risk of large losses, index call sellers must either rapidly move into cash until the market decline abates, or use long index put positions to limit the damage. The former requires precise and difficult timing. The latter can be implemented cost-effectively and has, over time, helped achieve its capital preservation objective in rapidly declining markets.

To read the full report, go to www.financial-resource.com/Gateway.asp

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nvesting in Preferred Securities

Attractive yields and investment-grade credit ality make preferred securities an essential asset ss of any well-diversified portfolio.

Preferred securities defy simple descriptions and egories. Companies typically raise public capital issuing debt (bonds) or equity (common res). However, a middle-ground exists – preed securities.

To compensate for their subordination to senior bt, investment-grade preferred securities typically er higher yields than similarly-rated bonds with- reaching down to junk bonds. Of course, while y usually have less risk than junk bonds, investment-grade preferreds will carry slightly higher credit risk than similarly-rated bonds.

Investors can assess the relative credit risks of most preferreds using the ratings assigned by Moody's or Standard & Poor's. Because of their regulated capital structures, companies in the banking, financial services and utility industries are the most common issuers of investment-grade preferreds.

Preferred securities consist of two basic types: traditional preferreds and "hybrid" preferreds. Traditional preferreds offer tax-advantaged income which may be appropriate for taxable accounts, while hybrid preferreds provide taxable income which may be appropriate for retirement accounts. Because of their differential tax treatment, traditional preferreds typically yield less than hybrids on a pre-tax basis – although their after-tax yield is generally higher than hybrids.

The terms and structures of traditional and hybrid preferred securities unfortunately are complex, can vary significantly and are constantly evolving. In addition, some preferred securities are targeted to institutions, and may not be available to private investors.

Individual investors should consider entering this complex market through diversified closed-end funds specializing in preferred securities. Closed-end funds offer professional management for a market where a thorough understanding of both credits and structures is critical to successful investing.

To read the full report, go to www.financial-resource.com/flaherty.asp

Flaherty & Crumrine Incorporated

Flaherty & Crumrine has over 22 years experience managing preferred and related securities portfolios using strategies designed to achieve high sustainable income.Its publicly-traded funds include: Preferred Income Fund (NYSE: PFD), Preferred Income Opportunity Fund (NYSE: PFO), Flaherty & Crumrine/Claymore Preferred Securities Income Fund (NYSE: FFC), Flaherty & Crumrine/Claymore Total Return Fund (NYSE: FLC); and in Canada, Investment Grade Preferred Fund (TSX: FAC.UN) and Investment Grade Fixed Income Fund (TSX: FFI.UN). • www.preferredincome.com • www.fcclaymore.com • www.flaherty-crumrine.com

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You Sold Your Company *What Next?*

Watching business owners start, grow, and sell their companies is still the same today as it was twenty-five years ago. After selling a business, the former owner will go through a period of excitement only to realize months later that it really is gone.

Within months after selling a company most business owners begin to experience similar feelings and emotions. Those emotions range from – "Was it right to sell the company?", "What will I do now?", "What will my new purpose in life be?", and "What should I do with the money?"

Most business owners are reluctant to invest in equity and fixed income markets because they lack the level of control they are used to having over their own company. Business owners are great at making their own business work, but not always good at investing as an individual. That is what can be referred to as the "$15 Million and Broke Syndrome." Success in business often does not translate into successful personal investing.

Several reasons go into this lack of investment performance. First, most former business owners do not realize the complexity of making good investment decisions. Second, they lack appropriate time frame for making a deci Third, is the absence of an annual plan. business owners know and understand detail about their company, but when it co to investing, they may not have the ability. The following list of ideas should used to guide the transition after sale:

- Take time to fully understand your new pur in life
- Seek experienced advisors who have witness many investment environments
- Consistently plan for three-to-five years in the future
- Review your progress on a semi-annual basis

To read the full report, go to www.financial-resource.com/oakley.asp

HERNDON PLANT OAKLEY Ltd
Registered Investment Advisors
Member NASD/SIPC

Advising former business owners is a major focus of Herndon Plant Oakley Ltd. After three decades of working with busin owners who sold their companies, the key word is experience. After defining objectives, the company's advisors go the ex mile to define and review. The company advises business owners from sale to transition to a planned future of continued s cess. For more information contact Rob Childers. Corpus Christi, TX • Houston, TX • 800.888.4894 • www.hpoinvestments.c

Four Strategies to Enhance Your Retirement Plan Investment Return

To provide a steady return, an investor should diversify over a broad range of asset classes. As you diversify, consider the following:

1) Dividend Paying Stocks - Since 1926, over 40% of an investor's return has come from dividends (Ibbotson Associates 1926-2000). In a sideways market, dividends become even more important. As 78 million baby boomers retire, they will seek to lower their risk and raise their retirement income. In the future, baby boomers will likely trade in their growth stocks for dividend paying stocks with a focus on high quality multinational brand name stocks.

2) Natural Resources/Commodities - The commodity cycle could be in its early stages. The increasing demand from China and India will continue to raise the demand for natural resources such as oil, timber and metals. For example, General Motors estimates there are only eight cars for every 1,000 people of driving age in China. In the USA, the ratio is nearly one to one. Both Ford and GM expect China to become the world's largest auto market, surpassing the USA.

3) International Investments - The US market experienced strong growth in the late 80s and 90s, supported by low federal and trade deficits, low inflation and oil prices, no major wars a strong dollar. Today, the opposite has occur Greater federal and trade deficits gener increase the downward pressure on the do Historically, international stocks outperform the dollar is weaker. Past performance is no indication of future results.

4) Rebalance Your Portfolio - As a diversi investor, rebalance annually or at a minim once every three years. Rebalancing helps ens that your asset allocation matches up with your and risk tolerance. Generally, a good choice for average investor is to maintain a moderate posit in both stocks and bonds/cash. Rebalancing is b done inside a retirement plan where you can tr without tax consequences.

To read the full report, go to www.financial-resource.com/christiansen

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Christiansen Investments, Inc., Registered Investment Adviser, specializing in monitoring and communicating investments 401(k) plans with plan assets in excess of $1,000,000. Primary customer base: financial institutions, law firms and manufa turing firms. 7100 West Donges Bay Road Mequon, WI 53092 • ci@ciadviser.com • 800.242.4735

astern Europe.....Russia Too!!!

lobal investors are beginning to see the vast opportities in Eastern Europe. From Austria to Russia, we witnessing strong performance from strong comlies. Traditional emerging markets such as Asia, n America and India should be measured against tern Europe when considering superior performe from quality international companies. In 2004 Eastern European region returned 53.2%, conting its strong performances from 2003 & 2002. tern Europe is a logical choice when looking for rnational exposure, diversification, and opportunity. mart investors recognize that the region is driv- these robust returns, therefore minimizing the need to take company or credit risk. Two mutual funds that exemplify the success of this discipline are: VEEEX, an Eastern European fund, and TMRFX, a Russian fund.

Why Eastern Europe? And will it continue? There are several fundamental reasons to believe this region will continue to perform well over time:

Eastern Europe's workforce is extremely well educated and relatively inexpensive. The literacy rate in Eastern Europe dwarfs that of India and Latin America. This educational advantage is one of the few lasting benefits from the former communist atmosphere.

Eastern Europe also has low corporate tax rates and low corporate litigation activity. These attributes are further enhanced by the region's tremendous natural resources. Oil and gas have received most of the headlines, but global demand for many raw materials and industrial commodities continues to grow.

Political stability and the Euro-convergence also play a big role in this region's rise to global strength. As Eastern countries continue to join the ranks of the European Union, they are increasingly incentivised to keep their "political and financial houses" in order. The West has taken note of this positive influence on inflation, interest rates, and budget deficits. Companies like Heineken, DaimlerChrysler, Siemens, Toyota and U.S.-based ConocoPhillips have recently opened operations in the former Communist Bloc.

To read the full report, go to www.financial-resource.com/worldfunds.asp

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The World Funds is a family of specialty mutual funds dedicated to offering unique products to investors. Our selection process begins with identifying superior money managers from a wide array of disciplines. The Family currently offers unique products such as a Russian fund, a Life Sciences fund, a Real Estate Income fund, and an Eastern European fund. To learn more: visit www.theworldfunds.com or call Hunter Elliott at 800.527.9525 ext. 7416.

hink you know everything bout RMDs?

he rules surrounding Required Minimum tributions are often confusing. The IRS clearly ndates that we begin taking annual withwals from our IRA accounts in the year that we ch 70 1/2. We may delay this first distribution til April 1 of the following calendar year, but we ist take a second distribution by December 31 that same year, which may cause a jump to the xt tax bracket. And, if we delay too long, the S applies a 50% penalty on those distributions t we should have taken, but didn't.

n the event the IRA participant dies, IRA stributions must continue, or must begin if they have not already. The deceased participant's IRA account must make the same distribution in the year of death than it would have had the participant lived. A surviving spouse will then begin taking distributions from the deceased participant's account by December 31 of the year following the year of the participant's death, based upon IRS life expectancy tables.

When an IRA participant dies before reaching the age of 70 1/2, the surviving spouse takes annual distributions based upon his/her life expectancy, but is not required to begin these distributions until the year following the year of the participant's death, or in the year in which the participant-spouse would have reached 70 1/2, whichever comes later. In the case of multiple non-spouse beneficiaries who are real persons, (not charities or trusts) the distributions are based upon the birthday of the oldest beneficiary, forcing younger beneficiaries to take larger annual distributions than necessary, and possibly paying more in taxes.

Confused? Don't worry, even many CPAs and CFPs find it perplexing. Consult with a retirement plan specialist, well in advance of your first required distribution, to avoid potential errors and minimize the tax burden.

To read the full report, go to www.financial-resource.com/householder.asp

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COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Eastman Chemical EMN	4502.5	55	-4	-13.8	34.2	282	8	0.6	5.3	1.3	3.18	2.18	6.16	5.79	7.0	B-
Ecolab ECL	8517.9	33	-5	10.8	20.4	518	26	1.9	15.2	1.9	1.05	1.19	1.34	1.51	13.0	A
Engelhard EC	3536.6	30	-4	9.5	16.6	245	15	0.8	NA	1.5	1.63	1.88	1.94	2.13	10.0	B+
FMC FMC	2017.8	53	10	4.3	16.9	209	13	0.9	6.7	1.6	0.00	4.70	4.28	5.43	8.0	B-
Fuller (H.B.) FUL (11)	901.2	31	9	-8.3	8.5	156	18	0.6	8.6	1.9	1.58	1.23	1.78	1.96	9.0	B
Georgia Gulf GGC	950.4	22	-44	11.8	29.4	277	9	0.4	5.8	2.1	1.15	3.17	2.82	4.08	4.7	B-
Hercules HPC	1326.5	12	-21	-19.0	130.3	2007	15	0.6	7.8	2.0	0.00	0.25	0.85	1.04	7.0	B-
Huntsman HUN	4202.8	19	NA	NM	0.0	318	NM	0.3	7.4	NA	0.00	-1.43	2.21	2.93	NA	NR
International Flavors & Fragrances IFF	3036.2	33	-24	13.9	23.6	327	14	1.5	9.8	NA	2.27	2.05	2.06	2.28	NA	B
Lubrizol LZ	2870.0	42	15	-6.9	10.9	182	17	0.7	8.1	1.8	2.46	1.67	2.94	3.26	8.0	B
Lyondell Chemical LYO	6279.2	25	-12	-47.1	14.6	226	16	0.4	6.0	2.1	3.54	0.29	2.84	4.01	4.2	B-
Monsanto MON (8)	19650.4	73	32	-16.8b	2.8	350	126	3.1	30.5	9.4	0.93	0.99	0.58*	2.57	13.5	NR
Mosaic MOS (5)	5238.4	14	-17	NM	5.8	151	28	1.0	11.4	NA	0.00	0.47	0.87	1.42	NA	NR
Nalco Holding NLC	2382.8	17	-14	NA	0.9	345	NM	0.7	10.6	4.0	0.00	-1.42	0.42	0.80	10.0	NR
Olin OLN	1380.2	19	-13	-18.3	28.2	315	11	0.6	7.1	1.7	4.16	0.74	1.60	2.03	7.0	B-
OM Group OMG	456.5	16	-51	223.7	10.8	89	8	0.3	4.3	1.1	0.00	4.39	1.37	1.21	11.0	B-
PolyOne POL	530.3	6	-36	41.4	2.3	133	58	0.2	8.9	1.3	0.00	0.20	0.56	0.69	6.0	C
PPG Industries PPG	10143.6	61	-11	2.6	20.1	306	16	1.0	9.7	1.5	3.10	3.95	4.62	5.11	8.8	B
Praxair PX	16759.8	52	18	16.8	17.9	433	25	2.3	12.5	2.1	1.38	2.10	2.47	2.81	10.0	A
Rockwood Holdings ROC	1345.7	18	NA	NM	-6.9	150	NM	0.4	8.8	1.7	0.00	-6.66	1.30	1.55	8.5	NR
Rohm and Haas ROH	9702.8	44	-1	13.3	16.6	254	16	1.2	NA	1.6	2.65	2.21	2.78	3.01	10.0	A
RPM International RPM (5)	2189.3	19	-5	8.5	9.2	200	23	0.8	13.1	1.7	3.44	0.86	1.34	1.49	8.0	B+
Schulman (A.) SHLM (8)	641.7	21	-2	24.4b	6.9	139	20	0.4	11.2	4.1	2.78	0.91	1.03*	1.08	5.0	B
Scotts Miracle-Gro SMG (9)	3153.0	47	28	-2.7a	9.8	308	32	1.3	NA	2.7	1.07	1.51	1.47*	2.62	12.0	B
Sigma-Aldrich SIAL	4437.9	66	9	16.7	21.2	368	18	2.8	13.0	1.7	1.15	3.34	3.81	3.97	10.0	A+
Valspar VAL (10)	2548.0	25	1	26.8b	13.9	240	18	0.9	12.6	1.8	1.75	1.35	1.42*	1.56	10.0	A-
Westlake Chemical WLK	1824.2	28	-16	18.4	21.7	198	9	0.8	NA	1.9	0.39	2.18	3.19	3.77	4.7	NR
(B) CONSTRUCTION MATERIALS																
INDUSTRY COMPOSITE	3895.0	62	12	13.1	11.1	260	28	1.5	10.1	1.3	1.33	3.54	3.49	4.40	13.6	
Lafarge North America LAF	4169.0	55	7	2.4	7.0	129	20	0.9	9.0	1.3	1.75	3.86	4.26	4.86	10.0	A
Martin Marietta Materials MLM	3477.6	75	40	4.1	15.1	289	20	1.8	8.6	1.0	1.22	2.64	3.85	4.55	18.8	B+
Texas Industries TXI (5)	1141.0	50	-20	42.5	7.8	310	50	0.7	10.2	NA	0.60	5.12	2.52	NA	NA	B
Vulcan Materials VMC	6792.3	67	22	3.5	14.6	314	22	2.5	12.7	1.7	1.74	2.52	3.32	3.78	12.0	A-
(C) CONTAINERS & PACKAGING																
INDUSTRY COMPOSITE	2866.2	30	-1	6.6	14.2	369	24	0.7	9.4	2.0	1.44	1.30	1.61	1.79	11.2	
Ball BLL	4330.4	41	-6	48.8	31.2	495	17	0.8	8.9	1.2	0.97	2.60	2.62	3.01	13.0	B+
Bemis BMS	2901.0	28	-5	8.2	12.2	214	19	0.9	9.3	1.9	2.61	1.67	1.47	1.64	10.0	A
Crown Holdings CCK	3090.2	19	35	NM	24.2	1493	64	0.4	9.8	1.3	0.00	0.30	0.87	1.24	17.0	C
Greif GEF (10)	1386.7	60	7	NA	14.3	190	13	0.6	NA	0.5	1.60	2.10	4.49*	3.50	27.5	B
Owens-Illinois OI	3323.8	22	-4	NM	13.5	269	16	0.5	4.6	1.5	0.00	1.00	1.36	1.65	11.0	C
Packaging Corp. of America PKG	2507.3	23	-2	-16.7	11.2	314	28	1.2	10.2	NA	4.31	0.64	0.42	0.60	NA	NR
Pactiv PTV	2903.8	20	-20	9.6	16.6	327	21	1.0	9.8	2.2	0.00	1.01	0.89	1.09	10.5	NR
Rock-Tenn RKT (9)	482.8	13	-12	-9.8b	3.9	106	27	0.3	4.8	3.4	2.69	0.27	0.49*	1.00	8.0	B
Sealed Air SEE	4253.5	52	-3	3.9	15.5	309	23	1.1	10.9	1.7	0.00	2.25	2.65	3.01	11.5	NR
Silgan Holdings SLGN	1312.9	35	16	23.1	32.0	467	15	0.5	6.3	2.8	1.13	2.26	2.48	2.64	5.0	B
Smurfit-Stone Container SSCC	3225.9	13	-32	NM	-12.4	164	NM	0.4	19.4	NM	0.00	-0.23	-0.41	0.06	7.0	C
Sonoco Products SON	2842.5	29	-3	-1.0	12.8	230	18	0.8	8.7	2.0	3.21	1.53	1.81	1.93	8.0	B+
Temple-Inland TIN	4699.2	42	22	-7.0	9.6	222	24	1.0	10.4	3.8	2.15	1.44	1.86	1.89	6.0	B
(D) METALS & MINING																
INDUSTRY COMPOSITE	6327.5	44	13	34.0	21.8	370	12	1.1	7.3	1.2	1.65	3.87	4.58	4.05	18.3	
AK Steel Holding AKS	910.3	8	-43	-26.9	-20.1	348	NM	0.2	6.3	0.7	0.00	0.28	0.60	0.93	20.0	C
Alcoa AA	23920.9	27	-13	-2.4	10.0	176	18	0.9	9.1	1.8	2.19	1.60	1.54	1.87	10.0	B+
Allegheny Technologies ATI	3220.0	33	52	-39.1	37.7	440	12	0.9	9.2	0.6	0.73	0.22	3.31	2.76	17.8	B-
Commercial Metals CMC (8)	2040.4	35	19	79.1b	31.8	227	8	0.3	5.6	1.5	0.68	2.21	4.63*	4.15	5.0	B+
Freeport-McMoRan Copper & Gold FCX	9590.6	52	36	34.5	47.2	2756	15	2.7	9.6	0.5	1.92	0.85	4.17	3.01	23.3	B
Metal Management MTLM (3)	634.3	25	-6	NM	20.3	169	9	0.4	7.3	1.5	1.19	3.74	2.33	2.82	7.0	NR
Newmont Mining NEM	20605.8	46	4	NM	5.8	247	43	4.7	18.1	1.0	0.87	1.10	0.90	1.33	50.0	B-
Nucor NUE	10438.9	67	28	38.6	32.0	255	8	0.8	6.2	1.7	0.89	7.02	7.94	6.18	5.0	B
Phelps Dodge PD	13770.5	136	37	95.8	30.3	236	8	1.6	6.0	NA	1.11	10.58	17.07	13.33	NA	B-
Quanex NX (10)	1562.8	62	35	51.5b	27.0	236	9	0.8	6.4	0.6	1.00	2.29	6.75*	5.11	15.0	B
Reliance Steel & Aluminum RS	2128.0	65	56	22.8	19.4	220	11	0.7	9.1	0.2	0.62	5.19	5.58	5.06	68.0	B+
Ryerson Tull RT	570.1	23	43	NM	18.1	107	5	0.1	4.3	NA	0.89	1.84	3.69	3.78	NA	B-
Southern Copper PCU	9365.2	64	35	59.2	38.8	294	5	2.6	6.4	0.3	10.69	7.46	9.19	7.19	20.0	B
Steel Dynamics STLD	1494.7	35	-8	46.3	29.3	183	8	0.7	4.6	1.7	1.15	5.27	4.15	3.92	5.0	B
United States Steel X	5397.1	48	-7	NM	26.7	120	5	0.4	3.3	3.4	0.84	8.37	6.94	5.74	2.0	B-
Wheeling-Pittsburgh WPSC	131.5	9	-77	NA	-1.4	46	NM	0.1	4.1	NM	0.00	5.58	-2.32	0.36	NA	NR
Worthington Industries WOR (5)	1786.4	20	4	48.3	17.9	213	12	0.6	8.6	1.8	3.35	2.03	1.47	1.40	7.5	B
(E) PAPER & FOREST PRODUCTS																
INDUSTRY COMPOSITE	7889.8	40	-7	43.5	5.3	164	33	0.8	13.1	4.2	2.38	1.42	1.77	1.79	6.6	

Investment Outlook Scoreboard

OMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
water BOW	1781.0	31	-29	NM	-3.8	126	NM	0.5	6.5	NM	2.58	-1.52	-0.46	0.57	5.0	B-
orgia-Pacific GP	12253.6	47	26	18.2	8.7	191	22	0.7	8.3	3.3	1.48	2.38	2.85	2.79	5.0	B-
ternational Paper IP	15462.3	32	-25	7.6	12.4	174	14	0.6	6.1	5.0	3.17	0.98	1.04	1.12	6.0	B-
uisiana-Pacific LPX	2850.7	27	1	138.3	20.4	145	7	1.1	5.3	1.2	1.85	3.87	3.18	1.84	7.0	B-
eadWestvaco MWV	5079.2	28	-17	NM	-12.6	146	NM	0.8	44.6	3.2	3.29	-1.73	0.79	1.21	11.0	B-
tlatch PCH	1411.3	48	-4	NM	1.9	204	105	1.0	14.3	10.1	1.24	0.52	0.96	1.30	5.0	B-
eyerhaeuser WY	16390.2	66	-1	9.9	10.1	162	16	0.7	7.0	2.4	3.02	5.43	4.02	3.73	7.0	B
ELECOMMUNICATION SERVICES																
ECTOR COMPOSITE	30826.1	24	1	0.5	16.4	287	27	1.8	9.3	3.3	2.13	-0.29	1.11	1.14	7.4	
3 TELECOMMUNICATION SERVICES																
NDUSTRY GROUP COMPOSITE	**30826.1**	**24**	**1**	**0.5**	**16.4**	**287**	**27**	**1.8**	**9.3**	**3.3**	**2.13**	**-0.29**	**1.11**	**1.14**	**7.4**	
A) DIVERSIFIED TELECOMMUNICATION SERVICES																
DUSTRY COMPOSITE	29357.2	19	-5	4.0	8.5	206	32	1.3	9.1	4.1	2.54	-0.70	0.85	0.84	4.6	
T&T T	97336.1	25	-3	-9.5	9.5	242	21	2.4	8.8	2.5	5.18	1.50	1.66	1.80	6.0	B+
ellSouth BLS	49913.1	27	-2	7.7a	11.3	205	18	2.4	7.8	2.4	4.26	1.85	1.76	1.96	6.4	A-
enturyTel CTL	4335.3	33	-7	27.9	9.6	122	13	1.8	5.0	4.4	0.73	2.41	2.53	2.34	3.0	A
itizens Communications CZN	4367.0	13	-5	NM	12.2	379	32	2.0	6.3	6.5	7.66	0.23	0.50	0.51	4.0	B-
T IDT (7)	1211.1	12	-21	NM	-6.1	123	NM	0.5	21.8	NM	0.00	-0.67	-0.45*	-0.33	5.0	C
evel 3 Communications LVLT	2381.7	3	0	NM	NM	NM	NM	0.6	19.4	NM	0.00	-0.67	-0.96	-1.12	8.0	NR
CI MCIP	6512.6	20	-1	NA	1.8	145	99	0.3	4.7	NA	0.00	-12.56	0.41	-0.08	NA	NR
west Communications International Q	9734.3	5	15	NM	NM	NM	NM	0.7	4.4	NM	0.00	-1.00	-0.31	-0.11	2.0	C
erizon Communications VZ	88423.9	32	-21	-10.1	21.0	225	11	1.2	4.0	4.7	5.07	2.59	2.54	2.58	2.7	B
B) WIRELESS TELECOMMUNICATION SERVICES																
DUSTRY COMPOSITE	35232.6	39	17	-13.5	34.9	475	17	3.2	9.8	2.0	0.90	0.94	1.88	2.06	14.9	
itel AT	25590.1	67	14	-13.5	10.2	198	16	2.8	9.4	3.4	2.30	3.33	3.46	3.62	5.7	B+
extel Partners NXTP	7168.8	27	35	NM	90.7	1085	14	4.3	9.4	1.4	0.00	0.19	0.80	1.04	23.8	NR
print Nextel S	72939.0	25	1	NM	3.9	142	21	2.4	10.6	1.2	0.40	-0.71	1.37	1.53	15.2	B
TILITIES																
ECTOR COMPOSITE	7213.6	34	7	3.3	10.7	229	25	1.1	55.2	3.4	3.44	1.85	2.08	2.32	5.5	
4 UTILITIES																
NDUSTRY GROUP COMPOSITE	**7213.6**	**34**	**7**	**3.3**	**10.7**	**229**	**25**	**1.1**	**55.2**	**3.4**	**3.44**	**1.85**	**2.08**	**2.32**	**5.5**	
A) ELECTRIC UTILITIES																
DUSTRY COMPOSITE	10190.5	34	7	2.3	9.0	180	17	1.2	154.3	3.4	3.42	1.84	2.14	2.32	5.2	
legheny Energy AYE	4531.2	38	41	-23.0	8.7	269	28	1.5	9.7	5.4	0.00	0.99	1.03	1.45	5.0	C
merican Electric Power AEP	14377.0	37	6	50.9	13.4	160	12	1.1	5.7	3.9	4.05	2.85	2.60	2.60	3.6	B
INergy CIN	8180.7	41	-1	-3.5	10.0	184	18	1.6	8.5	3.1	4.67	2.18	2.55	2.94	5.0	B+
dison International EIX	14700.6	45	41	NA	15.1	231	14	1.3	6.8	2.3	2.22	0.68	2.81	3.15	7.0	B
ntergy ETR	14519.5	70	4	7.3	11.7	165	15	1.4	7.2	2.3	3.09	3.93	4.43	4.84	7.0	B+
xelon EXC	34721.1	52	18	18.8	20.6	342	17	2.3	10.1	2.8	3.07	2.75	3.12	3.34	6.0	B+
irstEnergy FE	15489.1	47	19	-0.3	9.5	175	18	1.3	5.7	3.2	3.83	2.66	2.96	3.54	5.0	B+
PL Group FPL	16737.9	42	13	4.4	10.1	199	19	1.5	8.0	3.2	3.35	2.46	2.52	2.81	5.2	A-
reat Plains Energy GXP	2170.6	29	-4	30.3	13.2	176	13	0.9	6.7	4.5	5.71	2.39	2.14	1.99	3.0	B
awaiian Electric Industries HE	2140.5	26	-9	-5.1	9.2	176	19	1.0	NA	4.4	4.69	1.36	1.51	1.74	4.0	B+
orthEast Utilities NU	2416.1	19	-1	-11.0	-8.6	119	NM	0.3	45.9	2.4	3.77	0.91	1.13	1.20	7.0	B
epco Holdings POM	4106.7	22	2	-16.1	7.8	114	14	0.5	5.8	3.6	4.61	1.47	1.50	1.58	4.0	B
innacle West Capital PNW	4107.6	41	-7	-7.8	6.5	116	17	1.4	7.0	2.6	4.82	2.57	3.14	3.09	5.0	A
PL PPL	11176.1	29	10	2.9	16.6	260	16	1.8	7.9	2.3	3.40	1.89	2.06	2.24	6.3	B
rogress Energy PGN	11284.6	45	-1	0.6	9.4	143	15	1.1	6.2	3.9	5.27	3.10	3.09	3.11	3.8	B+
eliant Energy RRI	2788.4	9	-33	NM	-11.1	69	NM	0.3	2613.2	NM	0.00	-0.58	-0.32	-0.17	6.0	NR
ierra Pacific Resources SRP	2472.5	13	28	NA	4.9	137	27	0.8	8.2	2.9	0.00	0.17	0.59	0.70	8.0	C
outhern SO	25737.3	35	4	7.9	14.4	238	16	2.0	9.2	3.3	4.29	2.06	2.13	2.20	5.0	A-
estar Energy WR	1962.1	23	-1	-19.1	9.7	134	14	1.3	6.2	4.6	4.07	1.19	1.63	1.67	3.0	B
B) GAS UTILITIES																
NDUSTRY COMPOSITE	2204.7	34	4	10.6	13.0	211	16	0.9	8.1	3.4	3.64	1.87	2.06	2.25	5.6	
AGL Resources ATG	2744.7	35	8	15.3	11.9	189	16	1.2	9.1	3.3	4.18	2.28	2.38	2.57	4.5	A-
Atmos Energy ATO (9)	2139.9	27	-3	4.0b	8.5	134	15	0.4	6.8	2.6	4.74	1.58	1.72*	1.88	6.0	B+
aclede Group LG (9)	634.3	30	-4	4.2b	10.9	173	16	0.4	10.0	3.5	4.61	1.82	1.90*	2.02	4.5	B+
ational Fuel Gas NFG (9)	2720.5	32	14	21.9b	12.5	221	18	1.4	8.2	3.6	3.60	1.66	1.81*	2.38	5.0	B+
ew Jersey Resources NJR (9)	1171.0	43	-2	7.9b	17.4	267	16	0.4	10.6	2.6	3.39	2.55	2.71*	2.80	6.0	A
icor GAS	1772.4	40	9	21.9	15.6	227	15	0.6	6.4	6.1	4.64	1.70	2.20	2.39	3.0	B
neok OKE	2708.3	27	-3	13.2	19.5	195	11	0.3	6.0	1.5	4.08	2.30	2.34	2.16	8.0	A-
eoples Energy PGL (9)	1368.9	36	-18	-7.0b	9.8	171	18	0.5	7.2	4.4	6.07	2.18	2.05*	2.29	4.0	B
iedmont Natural Gas PNY (10)	1801.0	23	1	6.0c	10.4	195	19	1.1	10.1	4.1	3.92	1.27	1.27	1.33	4.5	A-
uestar STR	6358.5	75	40	9.6	22.4	483	22	2.7	11.7	2.1	1.21	2.67	3.63	4.68	10.0	A-
outhern Union SUG	2623.7	24	3	NM	5.8	151	NA	NA	NA	2.2	0.00	1.24	1.45	1.63	7.5	B
outhwest Gas SWX	1041.3	27	5	7.2	7.2	139	18	0.6	5.0	6.2	3.07	1.60	1.44	1.76	3.0	B+
GI UGI (9)	2299.3	32	8	29.2b	19.1	238	12	0.5	6.7	1.6	3.07	1.15	1.77*	1.63	8.0	A
VGL Holdings WGL (9)	1481.6	30	-1	4.8b	11.2	165	14	1.1	7.6	3.6	4.37	1.98	2.11*	1.93	4.0	B+

COMPANY STOCK SYMBOL (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2005 PRICE CHANGE %	EARNINGS GROWTH 2000-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2004 ACTUAL	ESTIMATES FROM ANALYSTS 2005 ANALYST EST.	2006 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
(C) MULTI-UTILITIES																
INDUSTRY COMPOSITE	6598.3	32	5	2.0	8.0	174	17	1.0	12.0	3.5	3.62	1.97	2.07	2.28	4.9	
Alliant Energy LNT	3305.4	28	-1	-18.4	6.1	129	19	1.0	6.4	4.0	3.70	1.85	2.03	2.06	3.5	B
Ameren AEE	10712.3	52	5	-3.9	10.1	166	16	1.6	8.2	5.5	4.84	2.84	3.18	3.31	3.0	A-
Aquila ILA	1325.6	4	-4	NM	-14.7	92	NM	0.9	NM	NM	0.00	-1.35	-0.26	-0.12	4.0	C
CenterPoint Energy CNP	4099.1	13	17	35.7	25.1	337	15	0.4	4.8	2.1	1.82	0.61	0.89	1.00	9.0	B
CMS Energy CMS	3064.4	14	34	NM	-1.2	133	NM	0.5	6.9	2.4	0.00	0.67	0.97	1.05	6.0	C
Consolidated Edison ED	11150.9	46	4	-4.2	8.5	152	17	1.0	9.1	5.2	5.01	2.32	2.91	2.99	3.0	B+
Dominion Resources D	26354.7	76	12	21.4	9.9	270	26	1.6	11.0	3.2	3.53	3.82	4.26	5.57	5.5	B+
DTE Energy DTE	7760.3	44	1	-6.0	5.6	143	25	0.9	6.6	2.6	4.72	2.55	3.32	4.00	5.0	B+
Energy East EAS	3463.6	23	-12	-5.8	8.2	115	14	0.7	6.6	2.9	4.95	1.62	1.78	1.88	4.5	B+
KeySpan KSE	5851.6	34	-15	NA	12.3	133	10	0.8	6.2	3.6	5.42	3.78	2.36	2.32	4.0	B
MDU Resources Group MDU	3934.1	33	23	10.0	14.2	222	15	1.2	8.3	2.1	2.31	1.76	2.12	2.40	7.5	[illegible]
NiSource NI	5869.0	22	-5	16.2	7.4	120	10	0.8	6.4	4.3	4.27	1.62	1.42	1.60	3.5	B
NSTAR NST	3000.2	28	4	2.5	12.7	200	15	1.0	5.9	3.4	4.13	1.76	1.84	1.95	4.5	B+
OGE Energy OGE	2423.6	27	1	0.0	11.6	178	15	0.4	7.1	5.1	4.97	1.72	1.74	1.83	3.0	A-
PG&E PCG	13729.2	37	11	NM	10.7	167	16	1.3	5.1	3.2	3.26	8.97	2.29	2.44	5.0	B
PNM Resources PNM	1785.8	26	3	-4.1	6.0	137	21	1.0	8.6	1.4	3.08	1.43	1.57	1.83	11.5	B+
Public Service Enterprise Group PEG	15007.8	63	21	-4.5	13.3	273	21	1.3	10.1	5.5	3.57	3.03	3.27	3.74	3.5	B+
Puget Energy PSD	2087.4	21	-16	-29.0	4.4	125	28	0.8	6.6	3.8	4.81	0.55	1.37	1.47	4.0	B
Scana SCG	4535.8	40	1	2.1	10.5	172	16	1.0	5.8	2.9	3.94	2.30	2.73	2.93	5.0	B
Sempra Energy SRE	11295.2	44	20	17.5	15.0	192	12	1.1	7.4	2.5	2.64	3.93	3.46	3.48	5.0	B
Teco Energy TE	3639.7	17	14	NM	-15.8	230	NM	1.3	118.2	4.4	4.35	-2.10	1.13	1.23	3.5	B-
Vectren VVC	2066.1	27	1	5.0	11.4	187	16	1.1	7.4	3.8	4.49	1.42	1.81	1.89	4.0	B+
Wisconsin Energy WEC	4439.5	38	13	NA	11.2	170	15	1.2	7.1	2.0	2.32	1.03	2.40	2.53	8.0	B
Xcel Energy XEL	7457.3	19	2	NA	9.6	139	15	0.8	5.8	5.0	4.65	1.27	1.22	1.33	3.0	B
(D) INDEPENDENT POWER PRODUCERS & ENERGY TRADERS																
INDUSTRY COMPOSITE	12880.5	36	22	-16.3	24.1	729	128	1.3	11.1	2.4	2.07	1.26	1.93	2.68	8.8	
Constellation Energy Group CEG	9453.4	53	21	10.3	9.6	169	17	0.6	8.5	1.3	2.53	3.40	3.50	3.66	12.0	B
Duke Energy DUK	24872.4	27	5	-14.9	15.3	156	11	1.3	5.8	3.3	4.62	1.27	1.63	1.75	5.0	B+
Dynegy DYN	1915.0	5	4	NM	-28.7	110	NM	0.6	NM	NM	0.00	-0.09	-0.32	-0.11	8.0	C
NRG Energy NRG	3524.2	44	21	NA	0.6	218	437	1.4	16.1	3.7	0.00	1.62	1.54	2.62	7.6	NR
TXU TXU	24637.7	51	59	-44.3	123.5	2990	47	2.5	13.8	1.4	3.22	0.10	3.31	5.31	11.3	B

Alphabetical List of Companies

The number following each company name identifies the Scoreboard category under which it is listed .

A

Abbott Laboratories 15b
Abercrombie & Fitch 5d
ABM Industries 17
Accenture 19b
ACE 12
Activision 19c
Acuity Brands 16d
Adobe Systems 19c
Advance Auto Parts 5d
Advanced Micro 20
ADVO 4
Aetna 14b
Affiliated Computer Svcs. 19b
AFLAC 12
AGCO 16f
Agere Systems 20
Agilent Technologies 21c
Agilysys 21c
AGL Resources 24b
Air Products & Chemicals 22a
Airgas 22a
AK Steel Holding 22d
Alaska Air Group 18b
Albemarle 22a
Alberto-Culver 8b
Albertson's 6
Alcoa 22d
Alexander & Baldwin 18c
Allegheny Energy 24a
Allegheny Tech. 22d
[illegible] 15b
[illegible] Energy 24c
Alliant Techsystems [illegible]
Allied Waste Inds. 17
Allstate 12
[illegible] 23b
[illegible] USA Energy 9b
[illegible] Group 7c
[illegible].com 5b
Ambac Financial 12
Amerada Hess 9b
Ameren 24c
American Axle & Mfg. 1a
American Eagle Outfitters 5d
American Electric 24a
American Express 11b
American Financial 12
American Greetings 2a
American Intl. Group 12
American Power 16d
American Standard 16b
AmeriCredit 11b
Amerigroup 14b
Ameriprise Finl. 11a
AmerisourceBergen 14b
AmerUs Group 12
Amgen 15a
Amkor Technology 20
Amphenol 21c
AMR 18b
AmSouth Bancorporation 10a
Anadarko Petroleum 9b
Analog Devices 20
Andrew 21a
Anheuser-Busch 7a
Anixter International 21c
AnnTaylor Stores 5d
Aon 12
Apache 9b
Apollo Group 3b
Apple Computer 21b
Applied Biosystems 15a
Applied Industrial Tech. 16g
Applied Materials 20
Apria Healthcare Group 14b
Aquila 24c
Aramark 17
Arch Coal 9b
Archer Daniels 7b
Arkansas Best 18d
Arrow Electronics 21c
ArvinMeritor 1a
Asbury Automotive 5d
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Atmel 20
Atmos Energy 24b
Autoliv 1a
Automatic Data 19b
AutoNation 5d
AutoZone 5d
Avaya 21a
Avery Dennison 17
Avnet 21c
Avon Products 8b

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Baker Hughes 9a
Ball 22c
Bank of America 10a
Bank of New York 11a
Banta 17
Bard (C.R.) 14a
Barnes & Noble 5d
Bausch & Lomb 14a
Baxter International 14a
BB&T 10a
Bear Stearns 11a
Beazer Homes USA 2a
Beckman Coulter 14a
Becton, Dickinson 14a
Bed Bath & Beyond 5d
Bell Microproducts 21c
BellSouth 23a
Belo 4
Bemis 22c
Benchmark Electronics 21c
Berkley (W.R.) 12
Berkshire Hathaway 12
Best Buy 5d
Beverly Enterprises 14b
Big Lots 5c
Biogen Idec 15a
Biomet 14a
BJ Services 9a
BJ's Wholesale Club 6
Black & Decker 2a
Block (H&R) 3b
Blockbuster 5d
BlueLinx Hldngs. 16g
Blyth 2a
BMC Software 19c
Bob Evans Farms 3a
Boeing 16a
Borders Group 5d
BorgWarner 1a
Boston Scientific 14a
Bowater 22e
Boyd Gaming 3a
Briggs & Stratton 16f
Brinker International 3a
Brink's 17
Bristol-Myers Squibb 15b
Broadcom 20
Brown Shoe 2c
Brown-Forman 7a
Brunswick 2b
Builders FirstSource 16b
Bunge 7b
Burlington Coat Factory 5d
Burlington Northern Santa Fe 18d
Burlington Resources 9b

C

Cabela's 5d
Cablevision Systems 4
Cabot 22a
CACI International 19b
Campbell Soup 7b
Capital One Financial 11b
Cardinal Health 14b
Career Education 3b
Caremark Rx 14b
CarMax 5d
Carnival 3a
Carolina Group 7c
Casey's General Stores 6
Caterpillar 16f
CB Richard Ellis 13
CBRL Group 3a
CDW 21c
Celanese 22a
Cendant 17
CenterPoint Energy 24c
Centex 2a
CenturyTel 23a
Charming Shoppes 5d
Charter Communications 4
Chemtura 22a
Chesapeake Energy 9b
Chevron 9b
Chiron 15a
Chubb 12
Church & Dwight 8a
Cigna 14b
Cincinnati Financial 12
CINergy 24a
Cintas 17
Circuit City Stores 5d
Cisco Systems 21a
CIT Group 11c
Citigroup 11c
Citizens Communs. 23a
CKE Restaurants 3a
Clear Channel Communs. 4
Clear Channel Outdoor 4
Clorox 8a
CMS Energy 24c
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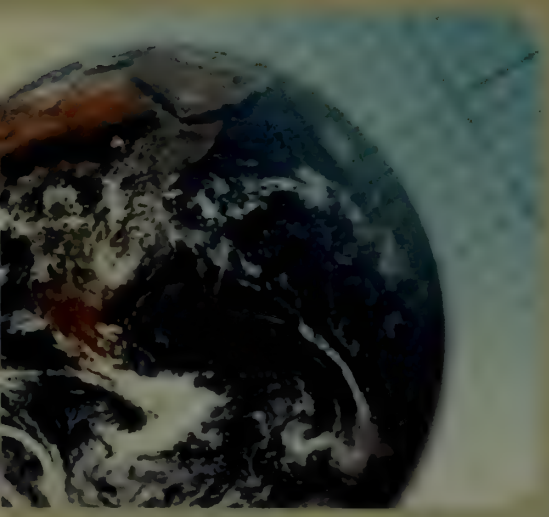
Health Horizons

Global Health — An American Priority

United States Surgeon General Vice Admiral Richard H. Carmona, M.D., M.P.H., F.A.C.S.

The notion that health is global isn't new or novel – it's as old as the spirit of adventure that has led people to travel the world. Just as Native Americans had no immunity to the viruses and disease that traveled with Christopher Columbus to the New World aboard the Nina, Pinta, and Santa Maria, Americans today are vulnerable to diseases that are emerging in villages, cities, farms, and jungles around the world.

Although new vaccines and treatments are becoming available, pathogens grow ever stronger through mutations. Faster than



ever before, they cross oceans and national borders aboard passenger aircraft, through agricultural and livestock trade, and animal migration. As we continue the timeless struggle fighting diseases, we are reminded of the importance of global health.

Our mission at the Department of Health and Human Services is to protect, promote, and advance the health and safety of the nation. It's a big job, and it's getting bigger – in part, because more than ever, the war against disease at home must be fought on a global battlefield.

Fortunately, as never before, those of us in the public health community – both here and in many other countries – are working together to prevent disease and advance the health and safety of all people. However, more cooperation is needed to prevent international health crises before they begin.

MEDICAL DIPLOMACY

We have the great privilege of living in this land of freedom and opportunities. With this privilege comes the responsibility to help others achieve freedom and democracy. But stable democracies and sustainable development cannot be built on the backs of unhealthy, broken populations where national life expectancy is only 50 years.

Medical diplomacy – relying upon America's compassion and generosity to use our medical expertise and financial resources – can be a powerful instrument in spreading hope, health, dignity, and democracy to many nations around the world.

America's Corps of Public Health Service Commissioned Officers are working side-by-side with other U.S. agencies, NGOs, non-profit organizations, and faith-based initiatives to deliver aid to less fortunate nations and improve the health of those lacking adequate healthcare.

Our response to last year's tsunami in southeast Asia, to earthquakes, floods, and famine no matter where they occur, and in building and equipping hospitals in war-torn nations like Iraq or Afghanistan demonstrates the power of medical diplomacy in generating goodwill.

Before I became Surgeon General, I had already developed a deep appreciation for how global public health can affect individuals, communities, and nations – including the United States. My understanding of the importance of global health grew from my work in Vietnam as an Army Special Forces medic and later as a trauma surgeon in Arizona. A defining experience in my own career was working with the Montagard tribal people in Vietnam as I observed how culture and national views shape healthcare, not only for one population, but can also influence or be influenced by the culture and national views of other populations.

Working as a trauma surgeon in Arizona, I saw people who had crossed the border from Mexico in order to receive medical care. I often didn't know if these patients would return to Mexico or remain to labor in Arizona's agricultural sector ... but I did know that their health would affect not only themselves and their livelihood but also the well-being of their families and communities.

The issue of 'global health' may have been foreign to many Americans just years ago – but with avian "bird" flu, SARS, mad-cow disease, and bio-terrorism much in the news, it has become evident just how important it is for us to focus on public health from a global perspective.

A GLOBAL CHALLENGE

One of the duties of my office – and one of my greatest challenges – is to inform and educate the American people about the critical health issues facing them today and tomorrow.

When it comes to disease prevention, it is a small planet after all. Viruses and bacteria, like terrorists, know no boundaries. Disease and pestilence can travel quickly, crossing continents, jumping oceans and ignoring national borders. Americans need to understand that their own well-being, as well as the health of their families, workplaces, schools,

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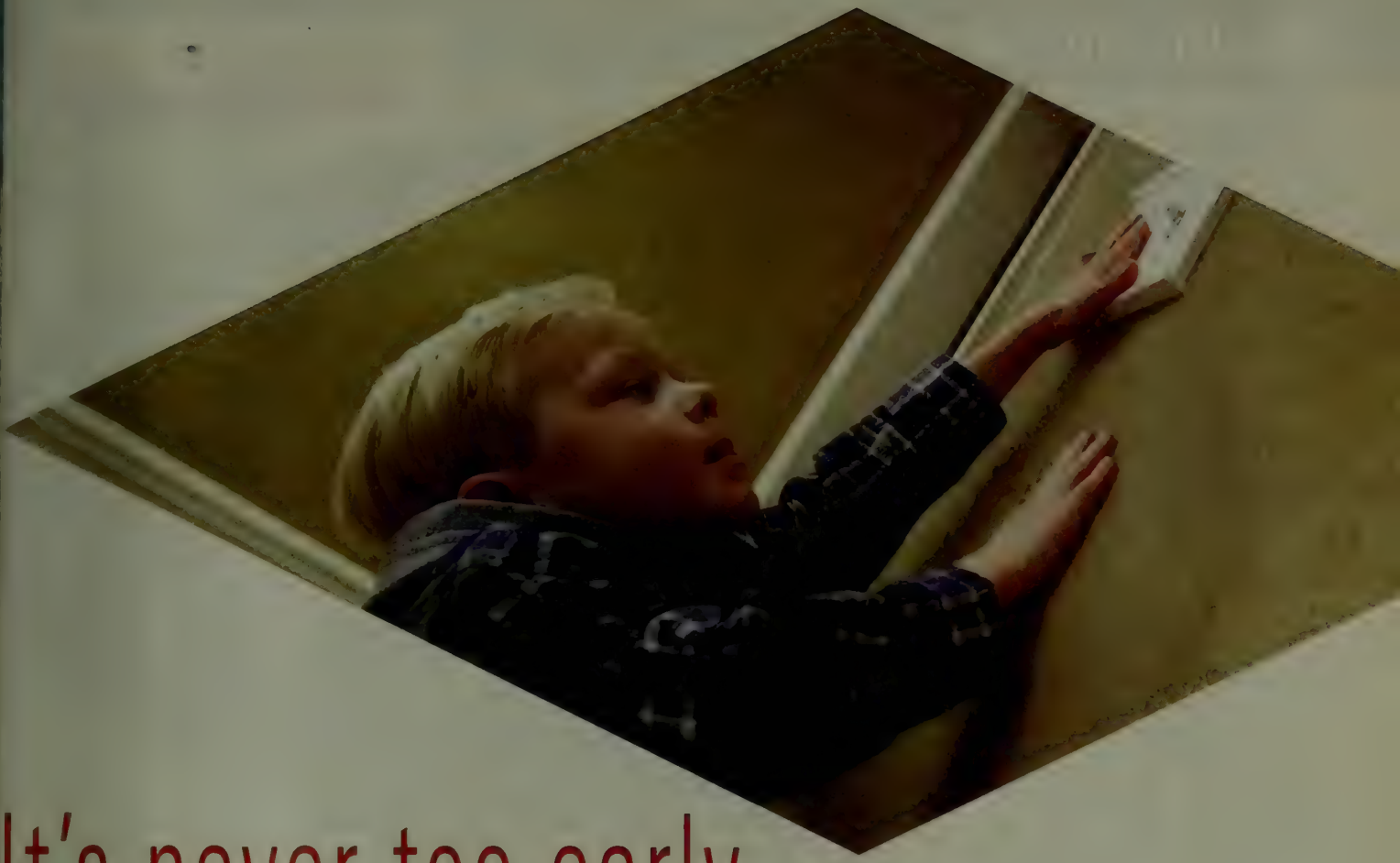

It's never too early to learn about energy efficiency.

We started 100 years ago.

For nearly a century, we've focused on using energy with care. We helped pioneer the use of cogeneration – recovering waste heat to make power and steam – to produce products more efficiently. We've continually set and achieved aggressive voluntary goals to reduce our energy use. And many Dow products help make homes, buildings, and vehicles more efficient. Now we're helping commercial and residential consumers save energy by supporting national conservation campaigns. There isn't one quick answer to the world's need for energy, but we're doing everything in our power to be part of the solution. Meanwhile, everyone, even a three-year-old, can turn off the lights.

Dow is proud to sponsor the Alliance to Save Energy's "The Power is in Your Hands" conservation campaign. For details and energy saving tips visit: www.powerisinyourhands.org.

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and local communities is more than ever connected to the health and well-being of people – and animals – around the world.

The greatest challenge to our technological and medical expertise in treating many of today's most threatening diseases is attacking them before they use our technological advances, including our greater mobility, to spread. As we face this challenge, we must always remember that our own health, both individually and as a nation, begins and ends in local villages, tribes, rural communities, small towns, and major cities all over the world. If for no other reason, the United States must take the lead in the area of global public health.

Corporate Health and Wellness Programs — A Business Necessity

Clinton L. Greenstone, M.D.; James M. Rippe, M.D.

The notion that the financial health and competitiveness of a business depends on the health and well-being of its employees is gaining acceptance. Some economists go even further, arguing that the U.S. economy cannot remain competitive in the global marketplace if we don't take better care of our workforce's physical and mental well-being.

The United States spends about 17 percent of its Gross Domestic Product on healthcare – and businesses incur a significant proportion of the cost. Most recently, this point has been driven home by the announced plant closures and layoffs at General Motors, arising in part from the huge financial burden of healthcare for its employees and retirees. Interestingly, the cost of healthcare incurred by U.S. automakers now exceeds the cost of steel.

Injury, chronic illness, and obesity each contribute significantly to the high cost of healthcare in this county. About three-quarters of premature deaths and two-thirds of chronic illnesses are preventable. The good news is that many prevention outcomes can be achieved through simple lifestyle interventions such as improved nutrition and physical fitness, stress management, and smoking cessation – and, increasingly, employers are providing resources to help employees adopt the needed lifestyle changes.

LIFESTYLE MEDICINE

The thoughtful adoption of healthier behaviors coupled with modern medical diagnostics, therapeutics, and risk stratification techniques comprise what we at Rippe Lifestyle Institute call "lifestyle medicine."

Company-sponsored lifestyle medicine programs will assuredly reduce healthcare expenditures, cut absenteeism, boost productivity, and improve personnel retention – all of which benefit the bottom line and bring a variety of intangible benefits to workers and their families.

Until the 1970s very few companies sponsored health promotion or wellness programs for their employees. Over the past 30 years interest has increased in proactive wellness. One recent survey indicated nearly 90 percent of all workplaces with more than 50 employees have some form of health promotion program. Many began with only onsite fitness facilities, then grew to include onsite health appraisals and nutrition counseling, and today some offer comprehensive programs that address smoking cessation, physical fitness, weight management, and other health issues.

Recognizing the high cost of employee chronic conditions and the benefits of good health, some companies, like The Dow Chemical Company, have shifted their focus and resources from the cost of healthcare to a broader view including the total value of health. Dow has implemented a company directed wellness program, focused on optimizing employee health and wellness and increasing productivity.

For some chronic diseases that are fairly common and expensive to manage – like congestive heart failure, asthma, or diabetes - enlightened employers are turning to "disease management" or "care management" programs offered by health providers, insurers, or companies like Pfizer Health Solutions Inc. By helping patients learn about their conditions, change their behavior and adhere to

HEALTHY DIRECTIONS

It's easier than you think

In June, Pfizer Inc launched a program unlike anything previously available at the world's largest healthcare company. Healthy Directions is a personalized, integrated health management program designed to encourage Pfizer's colleagues and their dependents to become more involved in their own healthcare decisions.

While other companies have adopted programs to improve employee fitness and help reduce healthcare costs, Pfizer's Healthy Directions program takes the concept one step further. The program offers a comprehensive, confidential approach to health improvement that produces measurably better health and increased productivity. This is in keeping with Pfizer's firm belief that our nation's healthcare system needs to transform itself from traditional "sick care" to proactive "well care."

The focus of Healthy Directions is on the integration of information, early diagnosis and timely treatment of chronic conditions, which include these components:

- **24-hour Nurse Line** – provides access to health experts who can answer an array of health questions;
- **Health Resource Website** – powered by WebMD® and available via a secure Internet connection;
- **Health Questionnaire** – a health risk assessment tool that provides a detailed report on participants' overall health status and potential risk factors;
- **Health Improvement and Management Programs** – designed by health improvement leaders to help participants achieve their health goals and/or manage a chronic condition or illness.

Pfizer is committed to the health of its employees and their families, and Healthy Directions' unique program design demonstrates that commitment. Healthy Directions is just one example of the kind of programs and services from Pfizer Health Solutions that emphasizes the value of good health and not just the cost of healthcare.

The Best Medicine.

PREVENTION

Healthy Choices.

Good health is important to all of us. Staying active and living a longer, healthier life is a goal we all share.

At Pfizer, we believe that good health starts with good choices. That's why our website, www.PfizerforLiving.com, provides information about good nutrition and exercise to help you make healthy choices that work for your lifestyle.

And that's why we offer our employees a personalized and comprehensive health management program designed to help Pfizer colleagues and their families be their healthiest. One-on-one health coaches help families understand and better manage their diagnosed conditions. And a 24-hour nurse line and confidential website are available to our colleagues to answer their health questions, day or night.

Good information, good choices *and* good medicine. That's what Pfizer believes is the best prescription for keeping America healthy.

Pfizer

www.pfizerforliving.com

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treatment plans, care management can help improve health and quality of life thereby reducing the need for ER and hospital visits due to complications. This, in turn, can reduce the number of employee sick days and improve productivity.

HEALTHY RETURNS

Although many employers offer health promotion programs of one sort or another, much more can and should be done. Some businesses remain skeptical believing "these issues don't apply to my industry" or "the evidence on expected return on investment is lacking" or "it's too hard to track outcomes." But most companies have sufficient data on healthcare costs, absenteeism, time lost at work, and other key indicators to assess the success of a program. Indeed, a look at the data for some companies indicates the return or cost savings on each dollar invested in corporate wellness programs ranges from $3 to as much as $5 dollars.

Carefully designed and widely implemented corporate wellness programs incorporating lifestyle medicine (proper nutrition, fitness and stress management coupled with thoughtful and appropriate risk stratified use of more expensive high-tech diagnostics and therapeutics) can greatly improve the physical and mental health of our workforce with bottom line benefits for individual businesses, the Federal budget deficit, and the national economy.

WEB RESOURCES

Disease Management Association of America
www.dmaa.org

The Dow Chemical Company
www.dow.com

Free & Clear smoking cessation
www.freeclear.com

Pfizer Inc www.pfizer.com

Pfizer Health Solutions Inc
www.pfizerhealthsolutions.com

Rippe Health Assessment
www.rippehealth.com

Weight Watchers Corporate Solutions
www.weightwatchers.com/about/cpp/

Sustaining Peak Performance — Good Health Required

Top executives and managers need to sustain peak performance in the face of intense pressure and rapid change. Historically, companies have addressed only their employee's cognitive skills and capacities – investing in management training to improve leadership, communication, and other business skills.

But as Jim Loehr and Tony Schwartz, authors of The Power of Full Engagement, put it in their 2002 Harvard Business Review article "On the playing field or in the boardroom, high performance depends as much on how people renew and recover energy as on how they expend it, on how they manage their lives as much as on how they manage their work. When people feel strong and resilient – physically, mentally, emotionally and spiritually – they perform better, with more passion, for longer. They win, their families win and the corporations that employ them win." Such high level performance needs to be cultivated and assessed.

Many businesses understand the importance of annual health assessment programs for their senior executives just as they value management training programs as an investment in human capital. But rarely are the two – management training and health assessment – fully integrated to the get the most out of a company's executives.

Comprehensive executive health programs address and understand the health risks associated with a hectic, fast-paced executive lifestyle, filled with pressures, long hours, interruptions, deadlines, and frequent travel. The best programs deliver "high touch" and "high tech" medicine (using CT scans and other advanced diagnostics) combined with effective lifestyle counseling aimed at behavior modifications that address weight loss, eating habits, smoking cessation, and improved physical fitness.

Fitness is the best and most reliable marker and predictor of all-cause mortality and cardiovascular mortality. Assessing a patient's fitness is critically important and predictive. High levels of fitness are associated with lower cardiovascular inflammation, lower LDL "bad" cholesterol, and higher HDL "good" cholesterol. And, this translates into a lower risk of heart disease, the leading cause of death in the United States. It also translates into higher levels of performance at work and better overall health.

Once a clear risk assessment is complete it is critically important that the physician and executive develop an individualized "sustained performance" program. Such a plan should focus on enhancing the four key elements of the executive's life and health, as defined by Loehr and Schwartz:

- **Physical Capacity** – building endurance and promoting mental and emotional recovery;
- **Emotional Capacity** – creating the internal climate that drives the ideal performance state;
- **Mental Capacity** – focusing physical and emotional energy on the task at hand;
- **Spiritual Capacity** – providing a powerful source of motivation, determination and endurance.

Executives, managers, and workers throughout the organization can benefit from a well-rounded holistic approach: Develop your management, job-related, and interpersonal skills. Assess your health and adopt health lifestyles. Hone your physical, emotional, mental and spiritual capacities. These are the ingredients to ensure sustained high-level performance.

Clinton L. Greenstone, M. D. is Medical Director of the Rippe Health Assessment and Senior Scientist at the Rippe Lifestyle Institute.

James M. Rippe, M.D. is Founder and Director of Rippe Lifestyle Institute. He is author of numerous popular and professional books including Heart Disease for Dummies (Wiley 2004) and Weight Loss that Lasts (Wiley 2004).

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BY GENE G. MARCIAL

DESPITE THE SLUMP, CARPENTERS KEEP POUNDING AT HORTON.

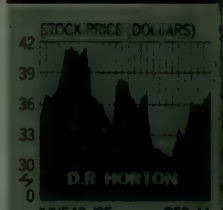
INSURER MONTPELIER RE IS A BUY—IN THE HURRICANES' WAKE.

A PUSH INTO CONSUMER GOODS IS BUOYING WESTERN DIGITAL.

Horton's Housing Is Hot

ABOUT TWO MONTHS AGO, when the Street began bailing out of housing stocks, Peter Zuleba III, senior portfolio manager at Glenmede Trust, began snapping up shares of D.R. Horton (DHI), the nation's No. 1 homebuilder. Investing in construction, he says, could be "stomach-crunching" for a while—already the stock has dropped from 43 in July to 38 on Dec. 14. But Zuleba thinks Horton is the best of the lot and the likeliest to continue performing well despite declining demand and rising interest rates. That's because Horton, specializing in entry-level single-family houses in 21 states, has "the best management in the industry" and has posted increased earnings each year since 1995, he says. The market is underestimating the long-term growth potential and operating improvements that management has put in place. To drive up margins, Horton has held down its material and labor costs, argues Zuleba. Scale and capital, he adds, give Horton a big advantage in buying land, building new houses, and opening new communities. He expects the stock to hit 45 in a year. The stock's depressed price, combined with a "solid earnings outlook," should give investors a strong return over the next year, says Stephen East of Susquehanna Financial Group. He sees a moderate housing slowdown, especially since the Federal Reserve signaled it may soon end further rate increases when it raised rates on Dec. 13. Solid growth will continue in 2006, forecasts East, who expects earnings of $5.99 a share on sales of $16.7 billion in fiscal 2006 and $6.61 on sales of $19.6 billion in 2007, up from 2005's $4.62 on $13.9 billion. At six times 2006 earnings, the stock is reasonably cheap, says East.

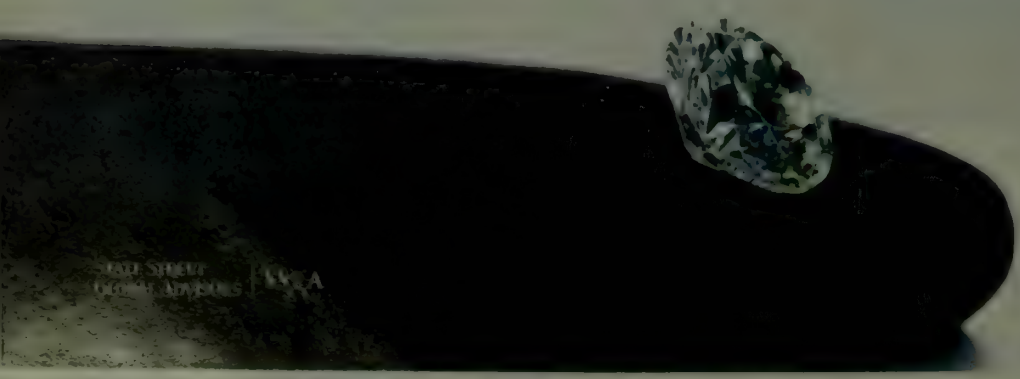
BUILDING HIGHER



Data: Bloomberg Financial Markets

30 Blue Chips in one

Diamonds (DIA) are all 30 gems of the Dow Jones Industrial Average wrapped up in one neat exchange tradec and of course, they are subject to similar risks. Ask your advisor for details. It's a smart way to add luster to your po



An investor should consider investment objectives, risks, charges and expenses of the investment company carefully before inve read the prospectus carefully before investing. *Usual brokerage commission applies. Dow Jones Industrial Average,℠ The Dow® and Diar with Dow Jones. Diamonds are not sponsored, endorsed, sold or promoted by Dow Jones and Dow Jones makes no representation regarding the advi Distributors, Inc., a registered broker-dealer, is distributor for the Diamonds Trust, a unit investment trust.

lontpelier Re: 'A Half-Off Sale'

IKE MANY INSURANCE STOCKS, Montpelier Re Holdings (MRH) has taken a beating. It's on "a half-off sale," says John Maloney of M&R Capital Management. ares plunged from 43 in March to 18 Dec. 14. Maloney bought at 19. The op was due to a $1.3 billion loss from e unprecedented five U.S. hurricanes. at far outstrips the Bermuda rein-rer's storm losses of $404 million last ar and $164 million in 2003. But aloney sees 2006 profits zooming, cause hurricanes will probably revert their usual pattern of two or three a ar. He also says insurance rates will e, boosting earnings. And there will less competition, with fewer nsurers taking big risks in 2006. Montpelier wrote an timated $1 billion in policies in 2005, vs. $870 million in 04, says Maloney. He forecasts below-consensus 2006 rnings of $3.50 a share and $3.60 in 2007, up from a loss in 05. Big players own fat stakes in the stock: Fidelity vestments, 13%; and White Mountain Advisors, 19%.

Vhy Western Is Heading North

WESTERN DIGITAL (WDC), the second-largest maker of hard drives, has bumped up from 11 in October to 15 now, reflecting strong sales growth in PCs and usic players, DVDs, and video games. Bernie Schaeffer of Schaeffer's Investment Research, which owns shares, says expanding beyond PCs not only drives growth but also reduces earnings volatility. He expects solid fourth-quarter earnings after profits jumped 126% in the third quarter and revenues leaped 23%. Yet Western remains cheap, he says, selling for just 11 times his earnings forecast of $1.36 a share for the year ending June 30, 2007. (Zacks Investment Research puts the consensus 2006 estimate at $1.16, vs. 2005's 91¢.) According to Zacks.com, only five of the 14 analysts who cover Western rate it a buy, three tag it a sell, and the rest are neutral. Schaeffer, however, figures the stock, which hit 54 in 1997, could double in a year. Richard Stice of Standard & Poor's, who rates Western a buy, says its push into consumer electronics will let it participate in the growth of cell phones, digital cameras, and portable music devices. So Stice predicts gross margins will widen from 16.2% in 2005 to 17.5% in 2006 as a result of higher sales volume, manufacturing efficiencies, and a less volatile pricing environment. He also figures the stock will benefit from increased share repurchases in 2006. From May, 2004, through September, 2005, Western bought back nearly 8 million shares. ■

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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Personal Business Figures of the Week

STOCKS

COMMENTARY

Stocks lost their footing at the start of the week with oil topping $60 a barrel. But record profits from Lehman Brothers, coupled with the hint from the Federal Reserve that rate hikes would be coming to an end, lifted spirits and sent the markets higher on Dec. 13-14. The S&P 500 stock index hit a year-to-date high on Dec. 14, as did the S&P Midcap 400 and S&P Smallcap 600.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	DEC 14	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1272.7	1.2	5.0	5.8
Dow Jones Industrials	10,983.5	0.7	0.9	1.9
NASDAQ Composite	2262.6	0.5	4.0	4.8
S&P MidCap 400	749.6	1.4	13.0	15.0
S&P SmallCap 600	361.5	1.2	9.9	11.7
DJ Wilshire 5000	12,733.5	1.2	6.5	7.6
SECTORS				
BusinessWeek 50*	766.4	0.7	8.9	9.4
BW Info Tech 100**	386.9	0.3	3.7	5.4
S&P/BARRA Growth	608.0	0.9	4.5	4.6
S&P/BARRA Value	660.4	1.5	5.6	6.9
S&P Energy	392.1	2.1	35.8	36.8
S&P Financials	431.4	1.7	4.9	6.3
S&P REIT	156.3	1.7	8.2	9.3
S&P Transportation	245.7	0.1	1.7	1.7
S&P Utilities	163.6	3.9	15.7	17.9
GSTI Internet	210.9	0.4	18.3	20.2
PSE Technology	853.8	0.1	9.6	9.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	DEC 14	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1515.5	2.7	8.6	[illegible]
London (FT-SE 100)	5521.1	–0.1	14.7	[illegible]
Paris (CAC 40)	4674.9	0.3	22.3	[illegible]
Frankfurt (DAX)	5286.8	0.4	24.2	[illegible]
Tokyo (NIKKEI 225)	15,464.6	–0.1	34.6	[illegible]
Hong Kong (Hang Seng)	14,976.3	–1.0	5.2	[illegible]
Toronto (S&P/TSX Composite)	11095.8	–0.3	20.0	[illegible]
Mexico City (IPC)	18,054.0	4.7	39.8	[illegible]

FUNDAMENTALS	DEC. 13	WEEK AGO	YEA
*S&P 500 Dividend Yield	1.79%	1.80%	1.9
S&P 500 P/E Ratio (Trailing 12 mos.)	18.6	18.5	20.
S&P 500 P/E Ratio (Next 12 mos.)*	15.2	15.1	16
First Call Earnings Revision*	–1.88%	–1.83%	–0.2

*First Call

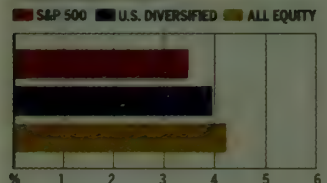
TECHNICAL INDICATORS	DEC. 13	WEEK AGO	REA
S&P 500 200-day average	1207.2	1205.8	Posit
Stocks above 200-day average	64.0%	63.0%	Neut
Options: Put/call ratio	0.68	0.74	Neut
Insiders: Vickers NYSE Sell/buy ratio	3.55	3.24	Negat

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Exploration	21.5	Oil & Gas Refining	93.2
Oil & Gas Drilling	17.4	Oil & Gas Exploration	72.7
Oil & Gas Equipment	13.9	Oil & Gas Drilling	63.2
IT Consulting	13.6	Oil & Gas Equipment	57.2
Gold Mining	13.4	Divsfd. Metals & Mining	49.4

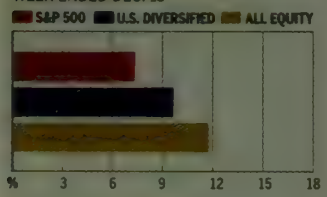
WORST-PERFORMING GROUPS	LAST MONTH %		LAS MONT
Home Entertainment	–9.2	Automobiles	–42
Genl. Merchandise Chains	–5.6	IT Consulting	–3
Biotechnology	–3.5	Photographic Products	–22
Airlines	–2.9	Internet Retailers	–2
Divsfd. Commercial Svcs.	–2.8	Auto Parts & Equip.	–20

MUTUAL FUNDS

4-WEEK TOTAL RETURN
WEEK ENDED DEC. 13



52-WEEK TOTAL RETURN
WEEK ENDED DEC. 13



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	13.3	Latin America	65.2
Japan	11.0	Natural Resources	47.7
Natural Resources	10.9	Diversified Emerg. Mkts.	38.2
Diversified Pacific/Asia	9.1	Japan	34.1
LAGGARDS		**LAGGARDS**	
Health	2.1	Domestic Hybrid	5.9
Domestic Hybrid	2.4	Miscellaneous	7.2
Financial	2.8	Large-cap Blend	7.5
Large-cap Value	3.2	Technology	8.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Precs. Mtls. Inv.	20.0	ING Russia A	79.7
Glenmede International	18.1	Guinness Atkn. Gl. Energy	73.8
Midas	16.5	Fidelity Advsr. Korea A	73.7
BlackRock Gl. Rscs. Inv. A	16.3	Gartmore Gl. Ntrl. Rscs. A	71.8
LAGGARDS		**LAGGARDS**	
STI Sm. Cap Val. Eq. C	–16.9	Ameritor Investment	–63.6
Ameritor Investment	–11.1	American Heritage Grth.	–42.9
Potomac Sm. Cap/Sh. Inv.	–9.4	American Heritage	–33.3
ProFds. USh. Sm. Cap Inv.	–9.2	Frontier MicroCap	–28.0

INTEREST RATES

KEY RATES	DEC. 14	WEEK AGO	YEAR A
Money Market Funds	3.70%	3.63%	1.51
90-Day Treasury Bills	3.89	4.02	2.23
2-Year Treasury Notes	4.36	4.40	2.96
10-Year Treasury Notes	4.48	4.51	4.12
30-Year Treasury Bonds	4.66	4.71	4.77
30-Year Fixed Mortgage †	6.23	6.24	5.64

†BanxQuote, In

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.92%	4.49%
Taxable Equivalent	5.60	6.41
Insured Revenue Bonds	4.05	4.58
Taxable Equivalent	5.79	6.54

THE WEEK AHEAD

PRODUCER PRICE INDEX *Tuesday, Dec. 20, 8:30 a.m. EST* » Producer prices most likely retreated 0.4% in November, and less food and energy, prices rose 0.2%. That's the median forecast of economists surveyed by Action Economics. In October, producer prices climbed 0.7% with the core measure falling 0.3%.

RESIDENTIAL CONSTRUCTION *Tuesday, Dec. 20, 8:30 a.m. EST* » Housing starts likely cooled to an annual rate of 1.99 million in November, after easing to a pace of 2.01 million in October.

PERSONAL INCOME *Thursday, Dec. 22, 8:30 a.m. EST* » In November income probably grew 0.3%, after a 0.4% rise in the prior month. Consumer spending likely rose 0.4%, after a gain of 0.2%.

LEADING INDICATORS *Thursday, Dec. 22, 10 a.m. EST* » The Conference Board's monthly index of leading economic indicators is expected to have risen 0.3% in November, after a jump of 0.9%.

DURABLE GOODS ORDERS *Friday, Dec. 23, 8:30 a.m. EST* » November durable goods orders growth probably moderated with a 0.5% gain, after a 3.7% surge due to a rebound in aircraft orders.

NEW HOME SALES *Friday, Dec. 23, 10 a.m. EST* » New home sales probably slowed to an annual rate of 1.3 million in November, from 1.42 million in October.

The *BusinessWeek* production index rose to 264.2 for the week ended Dec. 3, and 13.5% from a year ago. Before calculation of the four-week moving average, the index retreated to 265.4.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit **www.businessweek.com/magazine/extra.htm**

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BusinessWeek

More than 500 top executives from around the world gathered in New York on December 1, 2005, to honor the energy industry's "Best of the Best." The Platts Global Energy Awards showcased extraordinary accomplishments from energy businesses worldwide. This year's nominees illustrate true innovative spirit and enduring commitment to customers, shareholders, and future generations.

Join us in celebrating the accomplishments of the 2005 winners:

CEO of the Year
Phillip G. Harris, PJM Interconnection

Coal Company of the Year
Foundation Coal Holdings, Inc.

Community Development Program of the Year
National Thermal Power Corporation, Ltd.

Downstream Business of the Year (tie)
Gazpromexport
World Energy Alternatives, LLC

Energy Company of the Year
ExxonMobil

Energy Engineering Project of the Year
Tennessee Valley Authority

Energy Investor of the Year
Iberdrola

Exploration and Production Business of the Year
Anadarko Petroleum Corporation

Industry Leadership Award
GAIL (India) Limited

Lifetime Achievement Award
André Merlin, RTE Energy, Inc.

Marketing Campaign of the Year
Southern California Edison Company

Most Innovative Commercial Technology of the Year
ExxonMobil

Power Company of the Year
Iberdrola

Renewables Project of the Year
MidAmerican Energy Holdings Company

Rising Star Award
Excelerate Energy, Limited Partnership

The 2006 Global Energy Awards Call for Nominations will be issued on June 1, 2006. For more information visit www.GlobalEnergyAwards.com

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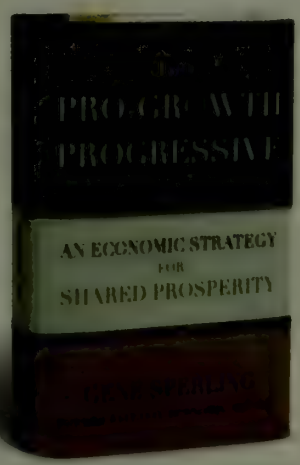
Seeing the Light of Growth

THE PRO-GROWTH PROGRESSIVE An Economic Strategy for Shared Prosperity
By Gene Sperling; Simon & Schuster; 354pp; $26.95

Sometimes it seems as if the Democratic Party has developed an allergy to the word "growth." John Kerry never once used the term in his three debates with President George W. Bush during the 2004 campaign. Even more surprising, Al Gore didn't mention growth in the 2000 Presidential debates, either, despite serving as Vice-President during an economic boom. Meanwhile, Republicans, and Bush in particular, have consistently cited economic growth as the main justification for big tax cuts. Democrats seem to prefer to talk about economic security and redistribution.

That's what makes Gene Sperling's new book, *The Pro-Growth Progressive: An Economic Strategy for Shared Prosperity,* especially important. As a member of the Democratic government-in-exile, Sperling is a heavyweight in Washington. He served as President Bill Clinton's National Economic Advisor and then played a similar role in Kerry's ill-fated Presidential campaign.



The task Sperling has set for himself is easy to state but hard to execute: He wants to find a politically viable middle ground between Americans who feel left behind by the global economy and those who see the future as relatively bright. "Democrats cannot just be the party for you when something bad happens," writes Sperling. "They also need to be the party of your optimistic aspirations."

Although his arguments are not fully compelling, Sperling makes substantial headway toward his goal. For the general business reader, the virtue of this book is that it offers an early look at the potential economic and business themes of the next election, at least from the Democratic point of view. In one chapter he proposes that Democrats run on a platform "to spread wealth creation, and encourage entrepreneurship, risk-taking, and small business creation."

Sperling builds a case that pro-growth policies can be put in place without violating progressive values. For example, he strongly favors globalization as a positive economic force but wants to put in place a new "cost-sharing compact" to cushion any potential negative impact on workers. At the same time he wants to cool down the rhetoric about globalization by both supporters and critics. "The first step in moving beyond our polarized national debate on trade," he writes, "is to reduce the exaggeration on both sides about the costs and benefits of open markets."

While agreeing that minimizing income inequality is important, Sperling wants the Democratic Party to put more emphasis on fostering growth. "Our primary goal should be raising all middle-class and poor boats substantially," he writes, "even if the well-off boats rise at a similar or faster pace." And, compared with most liberal policymakers, he gives more explicit emphasis to fostering technological change, the main driving force for long-run growth. In particular, he calls for a sustained increase in expenditures for education and research, or what he calls an "Apollo equivalent."

Sperling believes in the importance of boosting national savings and reducing the federal budget deficit. However, he doesn't simply rely on the typical argument made by most economists, that such measures automatically lead to more growth. Rather, Sperling makes the more persuasive case that encouraging personal savings "is a vital ingredient in ensuring economic dignity and upward mobility." Moreover, he argues that fiscal discipline is required to "build public trust in government—a prerequisite for attracting support for expansive government initiatives."

The Pro-Growth Progressive lays out some innovative policy proposals. For example, to boost savings, Sperling suggests what he calls the Flat Tax Incentive, which is a flat 30¢ refundable tax credit for every dollar of saving by a worker. In contrast, current methods of encouraging savings, such as making 401(k) contributions exempt from taxation, tend to give heftier subsidies to higher-income workers (who get a bigger benefit from tax exemptions because they pay a higher marginal tax rate).

Ex-Clinton adviser Sperling says: Lift middle-class and poor boats, and don't fret if yachts rise even more

The book has several big problems, too. For one, Sperling sometimes can't stop himself from refighting old political battles from the Clinton years. And some of his language goes way beyond clunky, into almost a parody of economic blather. At one point he observes that "to achieve shared growth in the dynamism economy we must move toward a four-part strategy for cost sharing and adjustment assistance." That isn't likely to raise anyone's enthusiasm for growth.

Nevertheless, *The Pro-Growth Progressive* has the potential to shift the terms of America's political and economic debate. In today's world that's no small achievement. ■

–By Michael J. Mande

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IdeasViewpoint

BY CATHERINE ARNST

Check a Box and Save a Life

There are 90,000 deathly ill people in the U.S. currently waiting for an organ, and one of them is my friend, Rob Fasano. He is married to Susan Dooha, his partner of 28 years, and is the devoted father of Lily, a lively 6-year-old. And he is dying, for lack of a donor. If you have not checked off the organ donor box on your driver's license, please keep reading.

I first met Rob, who is 53, in 1998 through the agency we used to adopt our daughters. Rob, Susan, and I bonded over our shared quest for a child, and in November, 1999, we also shared the greatest joy of all our lives when we traveled together to China to receive our children. My daughter, Jesse, took an immediate shine to Rob and spent much of the two weeks we were in China grabbing his beard and bubbling over with laughter. As for me, I found his fabulous sense of humor, his patience, and his generosity the perfect antidote to my craziness as a first-time mother.

Our families have remained close since that China trip, and Jesse's love affair with Rob has never ended. We live near each other in Brooklyn, eat together regularly, vacation together, and Lily and Jesse are best friends. Since I am a single mother, Rob plays an important role in Jesse's life—she often says she thinks of him as a dad. Consequently, I was almost as devastated as Susan and Lily when I learned in August that Rob's liver was failing.

It wasn't a complete surprise. Rob has a genetic condition, alpha-1 antitrypsin deficiency, which causes cirrhosis of the liver in 12% to 15% of adult carriers. The only treatment is a liver transplant. Rob had his first transplant in 1990, after waiting nine months for a donor and nearly dying in the process. That liver started breaking down on Aug. 2, days after our families shared a lovely dinner outdoors.

THE FASANOS
Susan, Rob, and Lily

NOW ROB IS FRAGILE and near death. He had been on the waiting list at Mount Sinai Medical Center in New York until doctors there decided in early December that he had become too sick for them to do the operation. He was transferred to Cleveland Clinic, where doctors think he will recover if he gets a liver soon. "He is a tough guy," Susan says. "I believe in him, and I believe he can get well. If he can get a transplant, he will be restored to us."

Unfortunately, too many lives hinge on the word "if." Last year more than 6,000 people died in the U.S. while waiting for an organ, and 1,500 more were removed from the waiting list because they became too sick to undergo surgery. In recent years the number of people needing an organ has grown five times as fast as the number of donors.

This chasm between supply and demand has spurred some controversial practices. Members of LifeSharers.org, for example, pledge that they will donate their organs on the stipulation that fellow LifeSharers get first access. The nonprofit network has signed on 3,400 members since its inception in 2002. Founder David J. Undis describes LifeSharers as the best free-market approach to organ donation short of financial incentives, which are illegal: "We offer a very good trade. By donating your organs after you can't use them anymore, you could literally save your life."

But do we really want a free-market approach? Do we want patients who sign up with a closed network to get first priority, rather than those most in need of organs? It would be better to instead overhaul the entire donation process.

The U.S. currently uses an "opt-in" approach, which requires potential donors specifically to consent to having their organs harvested at the time of death. But several European nations, including Belgium, France, Spain, and Italy, have switched to an opt-out, or presumed consent, system: It assumes that citizens will donate their organs unless they specifically say no. Austria passed such a presumed consent law in 1982, and by 1990 the number of kidney transplants performed there was nearly equal to the number of people on the waiting list.

Right now, only about 30% of Americans are registered as organ donors. An opt-out system would almost certainly pull that number up significantly, and Congress could save tens of thousands of lives by passing such a law. Until it does, donation will take acts of commitment. So register today. For all the Robs out there. ■

Catherine Arnst *is a senior writer for* BusinessWeek *covering medicine and science.*

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IdeasOutside Shot

BY GUY PFEFFERMANN

Give Africa's B-Schools a Boost

As every gardener knows, plants flourish when they get exactly the amount of water they require. A sudden downpour is wasted: The ground cannot absorb it, and the runoff erodes the soil. The same goes with funding development in Africa and other poor regions. Too little money, whether domestic savings, export revenues, or aid to governments and nongovernmental organizations (NGOs), hampers progress. But too much is bad as well. Like plants, national economies can absorb only a certain flow of money usefully.

One of the often-overlooked determinants of absorptive capacity is management and business talent. Sadly, most of Africa's health organizations and local NGOs—many of which receive millions in aid—suffer from a lack of management skills. According to news reports, a key partner in the Global Fund to Fight HIV-AIDS, Malaria & Tuberculosis suspended operations in Uganda in August because some funding had gone astray. This was in part the result of corruption, but it also was due to a shortage of local accountants able to book foreign exchange receipts correctly.

This dearth of management training also hinders micro, small, and midsize businesses. These are the largest source of jobs in most developing countries. Yet in Africa few of them ever grow into larger companies. Research conducted in East Africa shows that the one factor that is strongly connected to the growth of small companies is whether owners or managers have university training. This finding cuts across ethnic differences and is true for locals, persons of Indian descent, or expatriates. In China, in contrast, most owner-managers of small companies have had some access to higher education. In short, business training pays off immeasurably.

Aid donors can relieve a critical shortage of skilled managers

The Report of the Commission for Africa, which British Prime Minister Tony Blair submitted to the Group of Eight last July, rightly flags management weakness in nearly every sector: water, health, transportation, and education. Yet nowhere does the report mention the need to strengthen local management schools. Leaving out South Africa, in all of the rest of sub-Saharan Africa—with one-tenth of the world's population—there are only a dozen small, high-quality business schools. No one expects any of these to become the next Harvard Business School. Rather, these schools aspire to provide basic management skills at affordable costs. But they can't supply business, governments, or NGOs with even a fraction of the skilled staff they need.

Why not simply "outsource" such training? Sending African students to foreign management schools all too often results in a brain drain, because students take jobs abroad after graduation. The only viable alternative is to strengthen the few promising management schools in Africa.

One reason aid donors have not focused on the acute shortage of skilled managers may be that international development goals have not stressed higher education. That's changing: The Blair report urges aid donors to help revive African universities, and four of the largest U.S. foundations (Ford, Rockefeller, MacArthur, and Carnegie) have started the Partnership for Higher Education in Africa. Also, the World Bank's International Finance Corp. has piloted the Global Business School Network to help develop African management schools.

A second reason is that many aid agencies abide by the wishes of African governments when making grants. Since many of the best management schools are private, governments are unlikely to include them in their "menus."

But perhaps the most important reason for neglect has to do with the way donors, whether governments or foundations, tend to view business schools. Business school students are not among Africa's poorest—indeed, most are middle-class. This alone disqualifies schools from receiving most financial support—even though, in the absence of any endowment, these schools all struggle for resources. If instead donors saw business schools for what they are—a desperately needed way to improve health-care delivery, NGO management, and small-business operations—maybe they would include them in the aid menu.

In October, the deans and directors of 22 African business schools from 10 countries met in Lagos, Nigeria, to establish the Association of African Business Schools. One of their objectives was to draw the attention of donors to the importance of management education in Africa's development. Isn't it time these fledgling schools received a helping hand?

GUY PFEFFERMANN *is director of the Global Business School Network of the International Finance Corp., a member of the World Bank Group.*